

JULY 20, 2012

# Private Student Loans

Report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce.



# Table of Contents

EXECUTIVE SUMMARY .....	3
INTRODUCTORY MATTERS .....	6
PART ONE: LENDERS, LOAN MARKETS AND PRODUCTS.....	9
PART TWO: BORROWER CHARACTERISTICS AND BEHAVIORS .....	35
PART THREE: CONSUMER PROTECTION .....	67
PART FOUR: FAIR LENDING ISSUES .....	78
PART FIVE: RECOMMENDATIONS .....	86
DATA APPENDIX I: FURTHER INFORMATION ABOUT DATA SOURCES	93
DATA APPENDIX II: ADDITIONAL FIGURES AND TABLES .....	96
STUDENT LOAN GLOSSARY.....	104
REFERENCES AND NOTES.....	109

# Executive Summary

American consumers owe more than \$150 billion in outstanding private student loan debt. While this amount is significantly less than the amount outstanding on student loans guaranteed by the federal government, the private student loan (“PSL”) product is an important component of higher education finance and does not appear to be well understood by the public.

In this Report, the Consumer Financial Protection Bureau and the US Department of Education seek to highlight key attributes of the private student loan marketplace, as well as consumer protection issues which policymakers may wish to address. Below are some of our key findings:

## **IN THE LAST DECADE, PRIVATE STUDENT LOAN ORIGINATION RAPIDLY GREW AND THEN PRECIPITOUSLY DECLINED.**

Fueled by investor appetite for asset-backed securities, the financial institution private student loan market grew from less than \$5 billion in 2001 to over \$20 billion in 2008, before contracting to less than \$6 billion in 2011.

## **DURING THE GROWTH PERIOD, PRIVATE STUDENT LENDER UNDERWRITING STANDARDS LOOSENEED.**

From 2005 – 2007, lenders increasingly marketed and disbursed loans directly to students, reducing the involvement of schools in the process; indeed during this period, the percentage of loans to undergraduates made without school involvement or certification of need grew from 40% to over 70%. As a result, many students borrowed more than they needed to finance their education. Additionally, during this period, lenders were more likely to originate loans to borrowers with lower credit scores than they had previously been. These trends made private student loans riskier for consumers.

## **SINCE 2008, LENDERS HAVE CHANGED THEIR UNDERWRITING AND MARKETING PRACTICES.**

After 2008 lenders rapidly increased the share of loans with a co-signer, from 67% in 2008 to over 85% in 2009. In 2011, over 90% of private student loans were co-signed.

In addition, in 2011, 90% of private student loans to undergraduates required the school to certify the student's need for financing. Lenders have also increased overall credit scores within their portfolios by tightening credit standards and reducing lending to nonprime borrowers.

### **MANY BORROWERS MIGHT NOT HAVE CLEARLY UNDERSTOOD THE DIFFERENCES BETWEEN FEDERAL AND PRIVATE STUDENT LOANS.**

Many private student loan borrowers did not exhaust their federal Stafford Loan limits before turning to the private loan product. Some borrowers reported that they did not know they had fewer options when repaying their private student loans than they did with their federal student loans.

### **SOME GROUPS OF BORROWERS USED PRIVATE STUDENT LOANS SUBSTANTIALLY MORE THAN OTHERS.**

In 2008, 42% of undergraduates at for-profit colleges took out a private student loan, while only 14% of all undergraduates used a private student loan.

### **MANY BORROWERS ARE STRUGGLING TO REPAY THEIR PRIVATE STUDENT LOANS.**

In 2009, the unemployment rate for private student loan borrowers who started school in the 2003-2004 academic year was 16%. Ten percent of recent graduates of four-year colleges have monthly payments for all education loans in excess of 25% of their income. Default rates have spiked significantly since the financial crisis of 2008. Cumulative defaults on private student loans exceed \$8 billion, and represent over 850,000 distinct loans.

### **PRIVATE STUDENT LENDERS ARE HETEROGENEOUS, WITH SOME DISTINCT SECTORS THAT PRESENT VARYING LEVELS OF RISK.**

Traditional financial institutions dominate the private student lending market. There are also non-profit state-affiliated lenders who produce a smaller volume of private loan products that are distinct from bank loans. Finally, institutions of higher education lend their own funds in a large number of small programs, about which there is very little public information.

The Director of the Consumer Financial Protection Bureau and the Secretary of Education have each put forth a series of recommendations to Congress to improve the private student loan marketplace and address consumer protection issues.

Richard Cordray, the Director of the CFPB, asks that Congress enhance the role of schools in the private student loan origination process, examine the appropriateness of the bankruptcy discharge standard, and modernize the regulatory framework to ensure a competitive, level playing field where consumers fully understand their debt obligations and lenders have appropriate data to make underwriting decisions.

Arne Duncan, the Secretary of Education, asks that Congress require institutions of higher education and private education lenders work proactively to protect and inform private student loan borrowers, work with the Department of Education and the CFPB to determine how to afford greater flexibility and relief to private student loan

borrowers who are experiencing financial distress, and amend the definition of private education loan to exclude other Federal education loans. Secretary Duncan also recommends that the Department of Education and the CFPB work with Congress to identify the necessary resources to provide a comprehensive picture of student borrowing that is inclusive of both federal and private student loans.

The study was informed by data provided by lenders in the marketplace, existing data sets maintained by the Department of Education, as well as input from financial institutions, the higher education community, consumer advocates, and individual borrowers.

# Introductory Matters

## STATUTORY MANDATE AND APPROACH OF THIS REPORT

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires the Director of the Consumer Financial Protection Bureau and the Secretary of Education to submit a Report on private student loans.<sup>1</sup>

This Report addresses the following topics, as set forth in the Act:<sup>2</sup>

- The private lenders, their market and their products, as they have evolved and performed over time,
- The consumers of these products, their characteristics, and shopping, usage and repayment behaviors,
- Consumer protections, including recent changes and possible gaps,
- Fair lending compliance information currently available and its implications, and
- Statutory or legislative recommendations to improve consumer protections.

The CFPB and the Department of Education (collectively, “The Agencies”) have approached these questions by gathering data from existing studies conducted by the Department of Education, gathering new market-wide data from the industry, and seeking public input. While the Agencies have consulted consumer and industry stakeholders in preparing this Report, the Agencies chose principally to use a data-driven approach using more detailed information than has been available in the past.

The approach in Part One of this Report is to tell the story of the origin, growth, evolution and near-collapse of the PSL industry. That story can only be understood in the light of the federal Stafford Loan program, which PSLs were originally designed to supplement and support. Federal Stafford loans are in many ways a better product than PSLs for large categories of consumers, so the story of PSL competition with Stafford loans is also important.

Against the backdrop of the PSL and federal student loan products, markets, and processes, the Report then explains (in Part Two) how consumers have interacted with

PSLs. The report provides an analysis of both industry-wide loan performance data and survey data collected over many years by the Department of Education’s National Center for Educational Statistics (“NCES”). Part Two also draws on the nearly 2,000 consumer comments received in response to a public request for information.

In the third and fourth parts, the Report addresses existing federal consumer protection laws and fair lending compliance issues in the ways that PSLs are provided to consumers.

Finally, the CFPB Director and the Secretary of Education each put forth recommendations to Congress, in accordance with the Act.

## DATA SOURCES AND TERMS USED IN THIS REPORT

The data sources relied upon in this Report are described in detail in the accompanying **Data Sources Panel**. The attached **Glossary** also explains the terms used in the Report to describe the PSL market and the various data sources.

## DATA SOURCES PANEL

### SAMPLE LENDER LOAN LEVEL DATA (LOAN- LEVEL DATA)

A data set created for this study in which records from all educational loan originations of 9 major lenders<sup>3</sup> for all loans originated from 2005 to 2011 were pooled and provided to the Agencies. The data does not identify the specific lender for each loan. Each unique borrower-lender pair is identified by a unique within-lender borrower identifier, so serial borrowing can be seen, but a borrower who borrowed from more than one of these lenders over the sample period would appear as two unique borrower-lender pairs that cannot be linked. The dataset consists of 5,456,689 unique records and 3,478,146 distinct borrower-lender pairs. Schools in the lender data are identified by Office of Postsecondary Education codes (OPEID), and the only demographic information available about borrowers is their state of residence.

### SAMPLE LENDER PORTFOLIO LEVEL DATA (PORTFOLIO DATA)

Quarterly performance data on educational loans originated and/or purchased by the 9 major lenders who provided the loan level data, aggregated across lenders. Each observation represents the performance of a single vintage (all loans originated in a specific year), and includes information about dollar volumes and counts of loans by status (e.g. current, 30-day delinquent, in forbearance, in default, in bankruptcy). The sample includes performance for all quarters of 2005 through 2011 for origination vintages 1999 through 2011, resulting in 295 records.

### SAMPLE LENDER QUALITATIVE RESPONSES

The 9 major lenders who provided the loan level and portfolio level data also answered a series of qualitative questions about current loan terms and conditions (as of December 31, 2011), historical changes in underwriting criteria (such as the use of cohort default rate), deferral and forbearance policies, and default management. The lenders were identified by a number or letter that changed with each set of responses, so that all of the data for one lender within one response can be connected, but it is not possible to connect a single lender across responses to multiple questions. Thus, for example, it is not possible to compare a specific lender’s underwriting practices to its current terms and conditions.

**STATE LENDER DATA** Lender de-identified, portfolio-level data provided by 5 state-affiliated non-profit lenders for educational loans entering repayment from 1997 to 2011. The sample includes annual performance data from 1997 through 2011.

**RESPONSES TO REQUEST FOR INFORMATION REGARDING PRIVATE EDUCATIONAL LOANS** In a Request for Information published in the Federal Register on November 17, 2011 the CFPB solicited comments on private education loans and related consumer financial products and services used to finance postsecondary education. By the closing of the comment period, January 17, 2012, nearly 2,000 comments were submitted. These comments can be accessed by visiting the [regulations.gov](http://regulations.gov) web portal. Docket No. CFPB-2011-0037 (Public Comments).

**NATIONAL POST-SECONDARY STUDENT AID STUDY (NPSAS)** Nationally representative survey of students enrolled in eligible postsecondary institutions in the United States and Puerto Rico conducted by the National Center for Educational Statistics every 3 or 4 years using institutional records, government databases, and student interviews. This study primarily uses the 2008 wave of the NPSAS which focuses on the 2007-2008 academic year, as well as the 2004 wave. NPSAS data was tabulated using the NCES PowerStats web application (<http://nces.ed.gov/datalab/>). Additional documentation about the NPSAS can be found on the NCES website (<http://nces.ed.gov/surveys/npsas/about.asp>).

**BEGINNING POSTSECONDARY STUDENTS (BPS)** Longitudinal study that follows a subset of NPSAS respondents who began their postsecondary education during a given NPSAS year, and includes both those who complete and who do not complete their degrees. For the purpose of this study, attention is focused on BPS:04/09 (NPSAS:04). BPS data was tabulated through the NCES PowerStats web application.

**INTEGRATED POST-SECONDARY EDUCATIONAL SYSTEM (IPEDS)** Annual survey of all post-secondary institutions that participate in federal student aid programs conducted by the National Center for Educational Statistics (NCES). Includes variables on enrollments, tuition and fees, student financial aid, and graduation rates. (<http://nces.ed.gov/ipeds/datacenter/>)

**POSTSECONDARY EDUCATION PARTICIPANTS SYSTEM (PEPS)** Department of Education's management information system for administering student financial aid. Includes school level data on topics including school characteristics, cohort default rates, and eligibility status. (<http://www2.ed.gov/offices/OSFAP/PEPS/dataextracts.html>)

**CONSUMER PRICE INDEX-ALL URBAN CONSUMERS (CPI-U)** Series ID CUUS0000SA0, 2002-2012, used to inflation-adjust other datasets. Downloaded from the Bureau of Labor Statistics website on April 13, 2012.



# Part One:

## Lenders, Loan Markets and Products

The PSL market consists of three types of lenders: (1) depository and non-depository financial institutions,<sup>4</sup> (2) non-profit lenders, many of which are affiliated with states, and (3) certain schools that elect to fund or effectively guarantee loans (institutional lenders). Financial institutions make up the majority of the market, with schools and state affiliates making approximately \$1.9 billion a year in new loans out of a total of \$7.9 billion in 2010-2011.<sup>5</sup> This Report focuses primarily on the financial institution segment of the market, but turns to the other market segments at the end of Part One. Before turning to the history of PSLs funded by financial institutions, this Report begins with a discussion of federal aid programs, which form the context for all PSLs, regardless of provider.

### A. THE BASICS OF STUDENT LOANS

#### **FEDERAL STUDENT AID PROVIDES A CRITICAL CONTEXT FOR UNDERSTANDING PSLs, WHICH WERE ORIGINALLY DESIGNED TO SUPPLEMENT FEDERAL LOANS AND GRANTS.**

Federal aid, in the form of loans, grants, and tax credits, makes up over two-thirds of direct aid to all postsecondary students.<sup>6</sup> This makes federal student aid far and away the most significant (non-familial) source of direct financial support for postsecondary students. PSLs make up less than 15% of total student debt outstanding as of January 1, 2012 and contributed less than 7% to the estimated \$112 billion in total student loans originated in 2010-2011.<sup>7</sup>

Students and parents who wish to take advantage of any federal student aid program must complete the Free Application for Federal Student Aid (“FAFSA”).<sup>8</sup> Eighty percent of families of dependent undergraduate students filed a FAFSA in 2010-2011.<sup>9</sup> The Department of Education processes the FAFSA to determine the Expected Family Contribution (“EFC”) which is the amount that the student and family are expected to cover directly from their income, assets or other sources, including loans. The Department of Education reports the student’s EFC to those schools that the student has indicated interest in attending. The school calculates the student’s “Cost of Attendance” - tuition, fees, books and other program charges, together with expected costs for food and housing, transportation, and other necessary expenses of the school year. Essentially, it is the student’s personal budget for the year. The school deducts the EFC from the Cost of Attendance, and taking account of other, non-Federal aid available, awards the student aid in the form of Federal Pell Grants, work study, other grant aid, subsidized Stafford Loans, and Perkins Loans to defray the difference. Unsubsidized Stafford Loans and PLUS Loans are also available. Federal student loans are not based on traditional measures of consumer creditworthiness such as past credit performance or ability to repay.<sup>a</sup>

The relationship of EFC to federal aid is critical to PSL borrowers: PSLs were originally designed as one method to finance the EFC,<sup>10</sup> and loan proceeds are considered resources available for education funding. If a student borrows more than the EFC, his or her overall federal aid can be recomputed and reduced and may even be subject to recapture to the extent that it has already been disbursed.<sup>11</sup>

The Department of Education offers three loan products that can be used to finance the EFC: the PLUS Loan (a loan to parents of undergraduates) and the Grad PLUS Loan (made to graduate or professional students), both of which use a credit check to determine borrower eligibility but not loan terms or conditions, and the unsubsidized Stafford Loan, which is not credit-based. Each of these loans competes with PSLs.

In addition, because a student can elect to use a PSL in lieu of a subsidized Stafford loan, in whole or in part, subsidized Stafford loans also compete with PSLs. Thus, demand for PSLs is closely tied to federal loan program dollar limits and eligibility requirements. Unsubsidized Stafford loans are now capped at \$31,000 for undergraduates (for four years),<sup>12</sup> and have annual caps of \$5,500 to \$7,500, increasing with years of education completed. Graduate and professional students may borrow up to \$138,500 in combined subsidized and unsubsidized Stafford loans.<sup>13 14</sup> As discussed below, while Stafford loans offer significant risk mitigation compared to PSLs, more than 40% of PSL borrowers do not exhaust their Stafford loan eligibility.

In summary, for the vast majority of students who file a FAFSA, PSLs exist as part of a mosaic of financial options that includes grants and federal debt. The college’s financial aid office is responsible to award aid controlled by the school and then “package” all the eligible financial aid and explain the EFC. The PSL should be a

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<sup>a</sup> PLUS loans require borrowers to not have an adverse credit history, but this is a more limited standard than traditional creditworthiness measures.

consideration in a context that requires the coordination of the school's financial aid office. In that context, the PSL can be a useful tool in the education finance toolkit.

## **B. FINANCIAL INSTITUTIONS AND THEIR PRODUCTS**

Prior to 2010, most Stafford loans were funded by private lenders (financial institutions, primarily banks), guaranteed by state or non-profit entities, and reinsured by the federal government under the Federal Family Education Loan ("FFEL") program.<sup>15</sup> Lenders also received supplemental payments under the FFEL Program.<sup>16</sup> Because Stafford loans are awarded as part of a school financial aid package, the school served as the gatekeeper in connecting students and lenders. Under Title IV of the Higher Education Act, the Department policed the schools' unbiased service as gatekeepers, through the anti-inducement rules, which prohibited explicit quid pro quo for the referral of a federal student loan.<sup>17</sup>

As a gatekeeper, the financial aid office could influence borrowers by referring students to one or more sources of FFEL loans, and lenders sought to be included on the school's "preferred lender list." One way a bank lender could distinguish itself in the competition to be named in the preferred lender list at a school was to offer a companion PSL that could also be awarded (or at least referred to) as part of the financial aid package to pay the EFC. Making PSLs available to FFEL borrowers from a school was not, until 2008, considered a violation of the anti-inducement rules.<sup>18</sup>

Prior to the lending boom period of 2005 – 2007, banks used the school financial aid award as their most direct method of marketing through the "school channel," as it was called. As with the Stafford loans being originated at the same time, the PSL lender would look to the school to review approved loans and "certify" that the borrower was enrolled and that the loan did not exceed the EFC. As with Stafford loans, PSL proceeds were directly disbursed to the school. In some cases, lenders even used the same technology platforms to communicate with schools about FFELs and PSLs.<sup>19</sup>

Thus, the creation of the PSL industry and its continued operation are intertwined with the mechanics of the federal aid process. The PSL came into existence as an adjunct to the federal student loan program, grew through federal student loan (FFEL) marketing channels, and shared processing and control systems with FFEL loan programs.<sup>20</sup>

### **PSLS ARE CREDIT-BASED PRODUCTS DESIGNED TO MIMIC KEY PRODUCT FEATURES OF STAFFORD LOANS - WITH DISTINCTIONS THAT ARE CRITICAL FOR CONSUMER AWARENESS AND RISK.**

From a consumer's perspective, Stafford loans and PSL products share many key features, and this may cause confusion for consumers.<sup>21</sup> Stafford loans do not require the borrower to repay while still in school.<sup>22</sup> Unsubsidized Stafford loans accumulate interest while the student is enrolled in school, and this interest is added to the

principal balance (capitalized). Stafford loans offer a six-month grace period after graduation before payments begin. Stafford loans offer additional deferment of payment upon return to school to complete a degree or conduct post-graduate study. These features are found in all of the PSLs reviewed in this study.

However, there are important differences. Nearly all American students are eligible for some form of federal student loan, without regard to traditional creditworthiness criteria.<sup>23</sup> In contrast, in the current market, most PSLs require at least one borrower to be “creditworthy”: currently employed, having a minimum credit score and, in more recent years, meeting other criteria such as a debt-to-income ratio.<sup>24</sup> Many undergraduates would not meet these requirements. Today, most PSLs for undergraduates (and a large number of loans to graduate students) must be co-signed by a creditworthy person.

A key distinction between federal student loans and many PSLs is interest rate risk. Today all federal student loans have fixed rates. Most PSLs are variable-rate loans with risk-based pricing, where pricing varies from consumer to consumer based upon an assessment of the creditworthiness of the borrower. Appendix Figure 1 shows the evolving mix of rate indices across the Sample Lender loan level data. Lenders have typically used LIBOR<sup>b</sup> and prime rate to govern PSLs. For undergraduates, some lenders are now offering fixed rates that appear to compete with Stafford rates, but these rates are comparable to Stafford rates only for students with the most creditworthy co-signers. Less creditworthy borrowers are offered fixed rates much higher than Stafford rates.<sup>25</sup>

While all Stafford borrowers are entitled to a single rate that may be reduced based on financial need, the rates for PSL borrowers vary widely with their credit scores. In terms of recent (December 31, 2011) offerings, the Sample Lenders reported low-end variable rates of 2.98% to 3.55% and high end rates (those paid by those with the worst credits) of 9.50% to 19.00%, with an average rate of 7.8%. These are initial rates in a very low rate environment and could increase substantially if interest rates rise generally. Fixed-rate risk-based pricing reported by Sample Lenders ranges from 3.4% to 13.99%.<sup>26</sup> The distributions of margins above the index rate are shown in Appendix Figures 3 and 4. Margins increased after the financial crisis of 2008, but have declined to some degree for most program types.

One final and critical difference between PSLs and the Stafford loans they emulate is the risk associated with future employment and the ability to repay. Stafford loans offer numerous adjustments for borrowers who have difficulty making payments. Income-based repayment and income-contingent repayment allow payments to be reduced, based on current income levels. Forbearance allows for a temporary reduction or cessation of payments, potentially for many months at a time. Even for a borrower who falls into default at 270 days past due, there are still programs to rehabilitate (cure) the default or consolidate to take the loan out of default.<sup>27</sup> Rehabilitation even results in an adjustment of the default notation in the consumer’s

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<sup>b</sup> Please see Glossary for definitions of key terms and concepts, including LIBOR

credit report.<sup>28</sup> With the exception of short-term forbearance periods, PSLs generally lack similar risk mitigation tools.

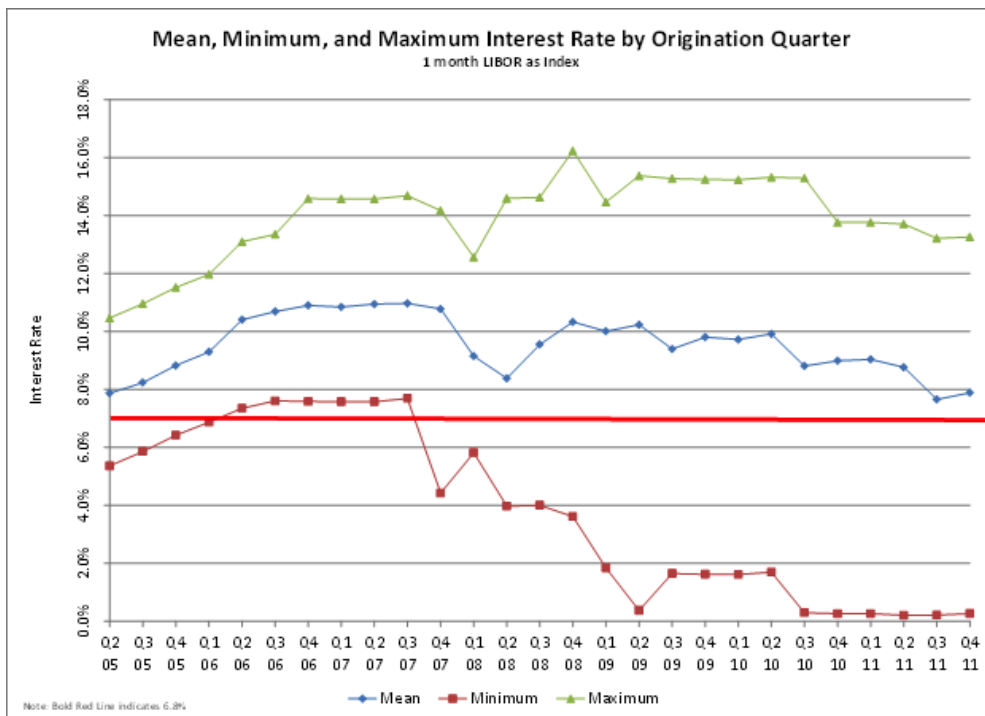
At 120 days past due, PSLs are generally placed in default and there are no current cure programs that eliminate a record of default.<sup>29</sup> Because PSL lenders currently require co-signers in 90% of loans, the Stafford loan repayment flexibility tools arguably should not be needed for PSLs. That is, Stafford loans do not control for ability to pay at origination, and the law provides for adjustments for those who cannot pay after separation from school. In contrast, if a PSL lender has already tested for ability to repay, there should be fewer cases where borrowers ultimately are unable to pay. As explained below, this may not be a correct assessment in all economic circumstances.

In summary, the PSL was designed to mimic a Stafford loan during school, but it has key differences which create risks for consumers if the future path of interest rates, the economy, and the labor market vary beyond initial expectations. If a significant number of consumers still confuse the two, that confusion may cause long-lasting and substantial consumer harm.

### **LENDER DATA CONFIRMS THAT PSL RISKS GENERALLY MAKE STAFFORD LOANS A BETTER CHOICE FOR MOST CONSUMERS.**

The general principles articulated in the preceding section are illustrated by the material cost differentials and rate risks experienced by PSL borrowers in the Sample Lender loan level data. PSLs have risk-based pricing, meaning that consumers are presented with a range of possible rates before they apply. Only after the lender approves the loan does the consumer receive a disclosure showing the actual, risk-based price for that consumer.<sup>30</sup> As shown in Figure 1 there can be a material difference in the initial rate. The red line in Figure 1 is the current unsubsidized Stafford rate of 6.8%, in effect since 2008.

**FIGURE 1: HISTORY OF INITIAL RATES FROM LOAN LEVEL DATA: MIN, MAX, AND MEAN (SAMPLE LENDERS)**

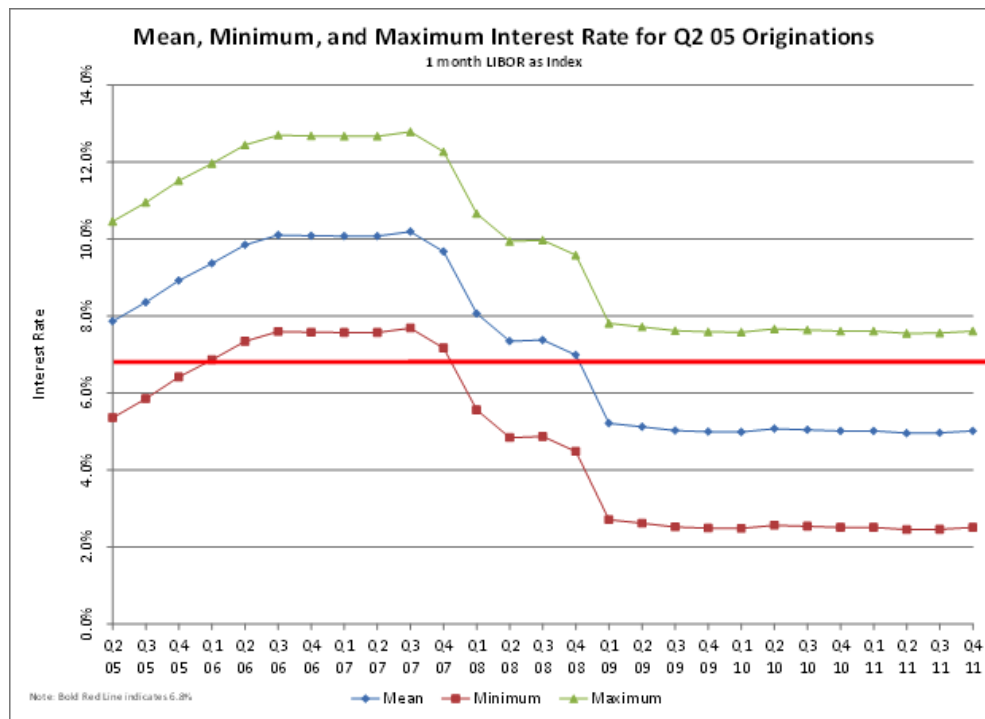


Source: Sample Lender loan level data

As illustrated in Figure 1, during this period it was possible to obtain an initial rate below the unsubsidized Stafford level, but only borrowers with the most creditworthy co-signers could do so. The mean borrower always started out above the fixed Stafford rate. The initial rate on a variable rate loan is also subject to rate variation risk. In today's historically low rate environment, the most creditworthy borrowers have temporarily won that gamble, as illustrated in Figure 2.

Figure 2 illustrates mean, maximum and minimum rates paid by Sample Lender loan level borrowers on 2005 cohort loans.<sup>31</sup>

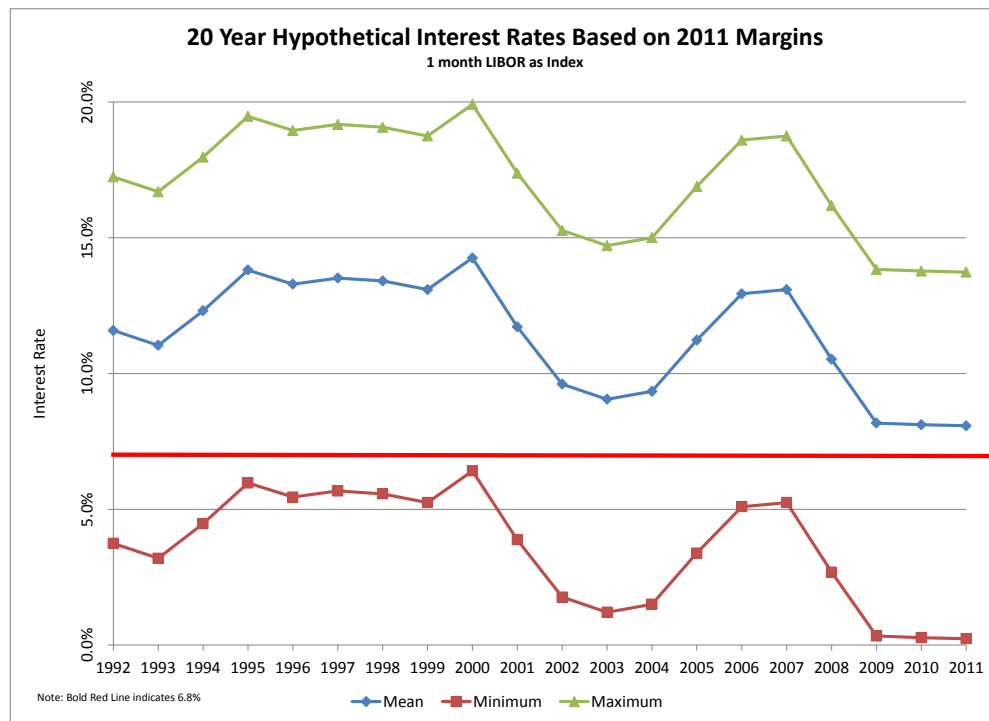
**FIGURE 2:** ACTUAL RATES PAID BY 2005 COHORT BORROWERS, MEAN, MINIMUM, AND MAXIMUM (SAMPLE LENDERS)



Source: Sample Lender loan level data

The current historically low rate environment is, however, an anomaly. A borrower needs to understand the history of rate movement in order to evaluate rate risk on a variable rate loan. In one standardized method of disclosing rate risk, The Truth in Lending Act (“TILA”) requires the lender to show a 15-year history for a 15-year home equity line of credit – illustrating what would have happened if the borrower had taken out the loan 15 years prior to the present-day application. Figure 3, below, applies the same methodology to hypothetical 20-year PSLs – using actual rate and margin data for loans in the Sample Lender loan level database. We used 2011 Sample Lender loan margin and historical LIBOR data to illustrate mean, minimum and maximum rate histories for such loans. The Index is three-month LIBOR, one of several common indices used for PSLs:

**FIGURE 3: HYPOTHETICAL RATES BASED ON HISTORICAL INTEREST RATES AND 2011 MARGINS (1992- 2011)**



Source: Sample Lender loan level data

As shown above, the strongest credits would have paid less than the Stafford rate, but the average (mean) PSL borrower whose loan was governed by 2011 loan margins would have never paid a lower rate than the Stafford rate. Perhaps more telling, those borrowers who pay the highest rates under 2011 structures would have paid between 13% and 20% interest, based on historical rates.

In summary, when considering the marketing, disclosures, processing or other factors that may influence a consumer choice of a PSL in lieu of a federal student loan, public policy should emphasize the choice of a federal student loan. To be sure, there is a relatively small subset of families who have the financial capacity to weather the incremental risks presented by the PSL product. For a family with the financial capacity to pre-pay a variable-rate PSL should rates rise, and with the ability to bear the financial burden of the loan should the student's future income not match expectations, a PSL may, in some circumstances, be an appropriate substitute for an unsubsidized Stafford loan.

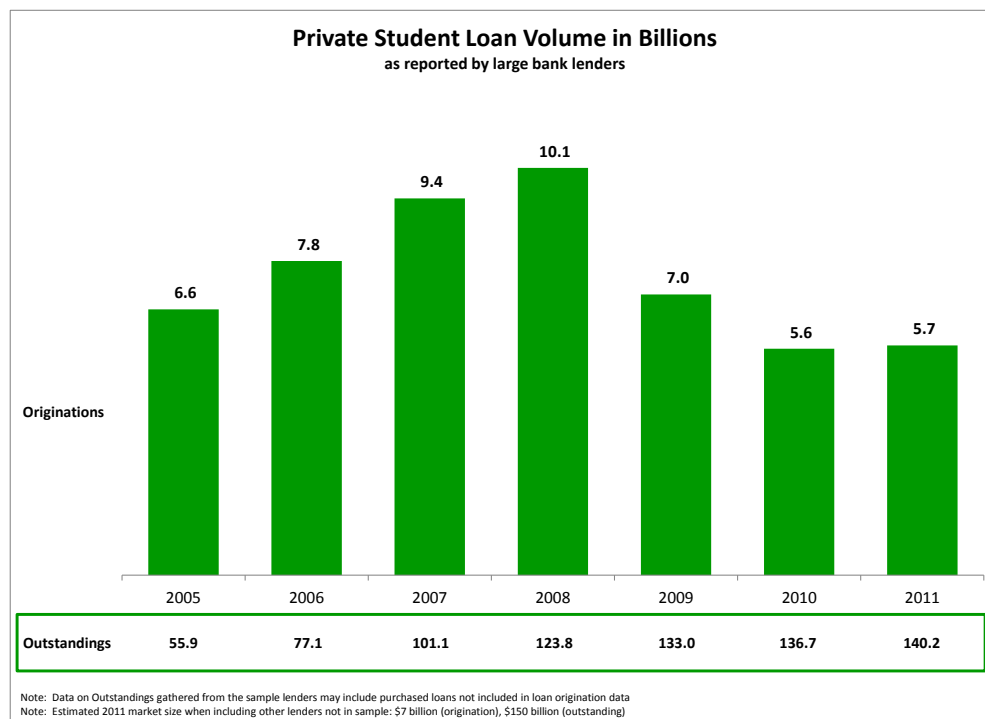
### THE FINANCIAL INSTITUTION PSL MARKET EXPERIENCED A BOOM AND BUST CYCLE IN THE LAST DECADE, FACILITATED BY THE ASSET-BACKED SECURITIES MARKET.<sup>c</sup>

<sup>c</sup> For an explanation of the securitization market and process, please see the entry on "Asset-Backed Securitization" in the Student Loan Glossary at the end of this Report.



The financial institution PSL market grew rapidly over the last decade and just as rapidly receded. According to the College Board, the financial institution market grew from less than \$5 billion in 2001 to over \$20 billion in 2008, and then rapidly contracted to less than \$6 billion in 2011.<sup>32</sup> The loan volume of the lenders in the Sample Lender Portfolio shows a similar trend. Note that the Sample Lenders consist of firms who weathered the market downturn and remained in business into 2012, using deposits and other “on-balance sheet” funding sources<sup>33</sup> in part during the securitization and lending boom (2005 – 2007)<sup>d</sup> and predominantly after the financial crisis. Figure 4 shows originations of PSLs by Sample Lenders by calendar year for 2005-2011:

**FIGURE 4:** ORIGINATION VOLUMES 2005 – 2011 (\$B’S) (SAMPLE LENDERS)



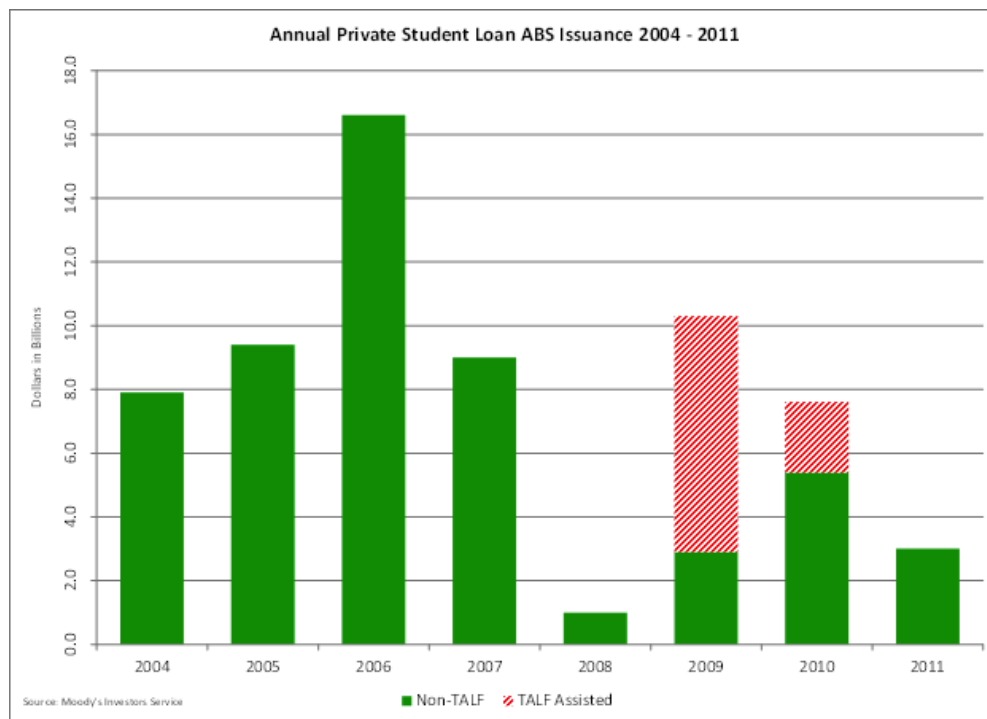
Source: Sample Lender loan level data

A large portion of student loan volume during the boom was funded by asset-backed securities (“ABS”). In this respect, the private student loan market resembled the subprime mortgage market. During the boom, high investor demand for student loan

<sup>d</sup> In the course of examining the sample lender data, the Agencies found that pricing began to rise and underwriting standards began to tighten in 3Q07 and accelerated dramatically in 3Q08. Due to the seasonality of student lending and the common use of multiple disbursement loans, our data tabulation reports a loan to be originated in the period when loan proceeds were first disbursed. Because of these complexities, it is difficult to pinpoint an exact moment when the “boom” period came to an end. For the purposes of this Report, we have defined the end of the securitization and lending boom period as occurring in 3Q07.

ABS (“SLABS”) allowed SLABS issuers to create structures with very low collateralization ratios.<sup>34</sup> As a result of these factors, \$100 in student loans could generate immediate cash proceeds from securitization of \$105 or more.<sup>35</sup> Generally speaking, the buyer assumed all of the risk that the borrower would fail to repay the loan after such a transaction. Therefore, a PSL lender had an incentive to increase loan volumes made for such a sale, with less incentive to assure the creditworthiness of those loans.<sup>36</sup> This dynamic provided the means and the incentive for PSL lenders and SLABS issuers to originate and securitize greater and greater amounts of PSLs between 2005 and 2007 (see Figure 4 and Figure 5). As developments in the asset-backed securities market in mid to late 2007 negatively impacted investor demand for SLABS,<sup>37</sup> PSL originations slowed dramatically.<sup>38</sup> As noted above, our Sample Lenders are largely composed of banks who had the ability to house loans on their balance sheets in the absence of the ABS market, thus the significant decline in PSL originations for our sample occurred in 2009 as the financial crisis spread from the “shadow banking system”<sup>39</sup> into the traditional banking system.

**FIGURE 5: PSL ABS ISSUANCE VOLUMES 2004 - 2011 - \$ BILLIONS**  
(SOURCES BELOW)<sup>40</sup>



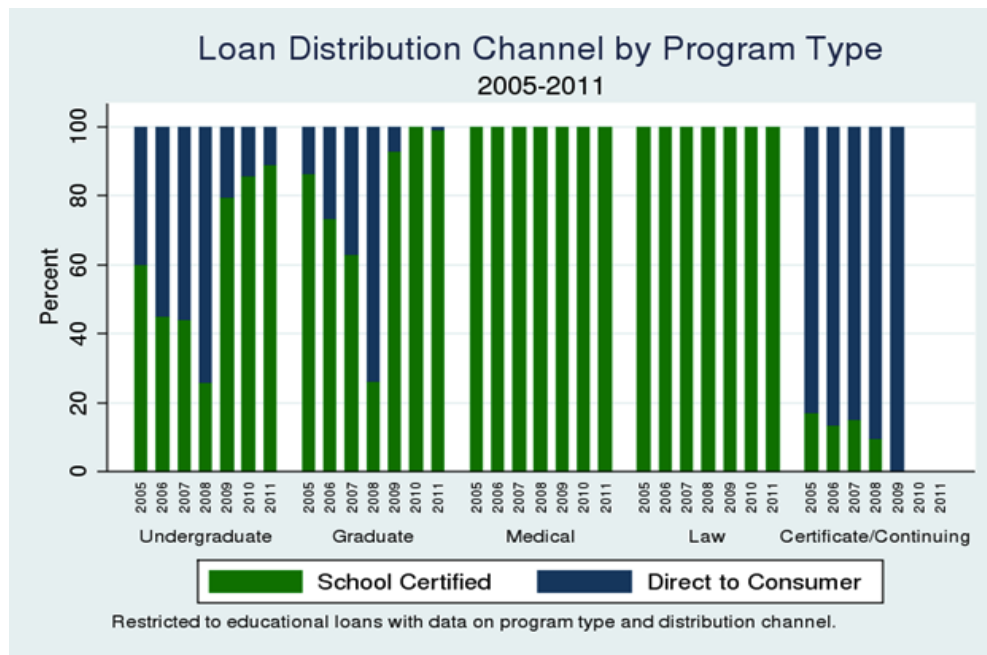
The ABS totals for 2009 and 2010 are inflated by the now-concluded TALF program (government-assisted transactions).<sup>41</sup>

## DEMAND CREATES SUPPLY: THE DIRECT-TO-CONSUMER CHANNEL AND LOAN AMOUNTS.

During the lending boom, PSL lenders sought to increase volume through a new marketing channel and processing protocol: Direct-to-Consumer (“DTC”). DTC

lending circumvented the school's financial aid office, marketing instead through mass media, online advertising, and direct media.<sup>42</sup> Funds were generally disbursed directly to the student, instead of to the school. The school did not certify the borrower's financial need, and the lender instead imposed a cap of the lesser of total cost of attendance or a fixed amount, such as \$30,000.<sup>43</sup> This new technique could simultaneously increase the number of borrowers and the amount each one borrowed. It also created an opportunity for the student to borrow more than the EFC.

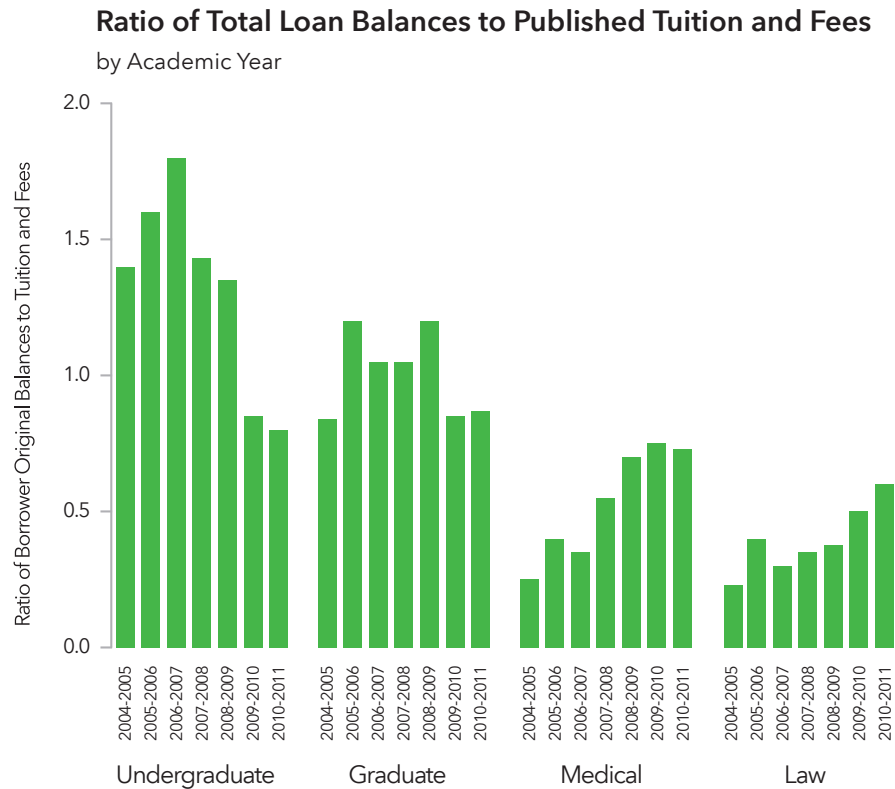
**FIGURE 6:** SCHOOL CHANNEL VERSUS DTC ORIGINATIONS BY PROGRAM BY CALENDAR YEAR (2005-2011)



Source: Sample Lender loan level data

Figure 6 illustrates the rapid growth of DTC lending and the retreat of school-channel lending (and associated certification) during the boom years. By 2008, 27.8% of undergraduate loans were school certified, down from 60.0% in 2005.<sup>44</sup> The eligibility for federal aid and the corresponding EFC, together with the school's determination of availability of scholarships and other non-federal aid are critical tools in determining how much private debt makes sense for a borrower, both in terms of excessive future loan payments and potentially jeopardizing federal aid. When separated from those tools, some students rapidly increased the amount they borrowed during the DTC-dominant years of 2005-2008. Figure 7 shows the average ratio, calculated at the borrower level, of PSLs to annual tuition and fee expense, at the borrower's school in the year in question, for borrowers in the Sample Lender loan level data.<sup>45</sup>

**FIGURE 7: PSL BORROWING AS A % OF TUITION BY PROGRAM TYPE (ACADEMIC YEAR) (SAMPLE LENDERS)**



Source: Lender loan level data, tuition and fees from IPEDS.  
Matched on OPEID and student's in-state status based on state reported to lender.  
Sample restricted to borrowers whose schools could be matched to IPEDS by OPEID.

As Figure 6 and Figure 7 show, undergraduate loan amounts and school certification of student need show a negative relationship. That is, loan amounts rose (as a percentage of tuition) as school certification decreased, and decreased when schools became involved again in later years, all in virtual lockstep. For medical and law students, where schools always remained involved, there was no comparable pattern.<sup>46</sup> Changes in undergraduate loan amounts could reflect changes in other aid or changes in other family financing options, but the data does not support those hypotheses.

According to the College Board, 2005 – 2011 was not a period of dramatic decline of uptake of other aid sources.<sup>47</sup> In other words, students were still receiving grants and loans from schools and the federal government at similar levels across the entire period to cover their overall cost of education. Changes in other family resources also fail to explain the spike in reliance on PSLs. During 2004-2007, PSL sizes grew, even though families had not yet lost access to home equity lines of credit (“HELOCs”), cash-out home equity refinance loans, and other financial products that could support borrowing, as happened in the subsequent recession. In fact, if family income and assets drove the size of PSLs, the decline in household resources during the recession

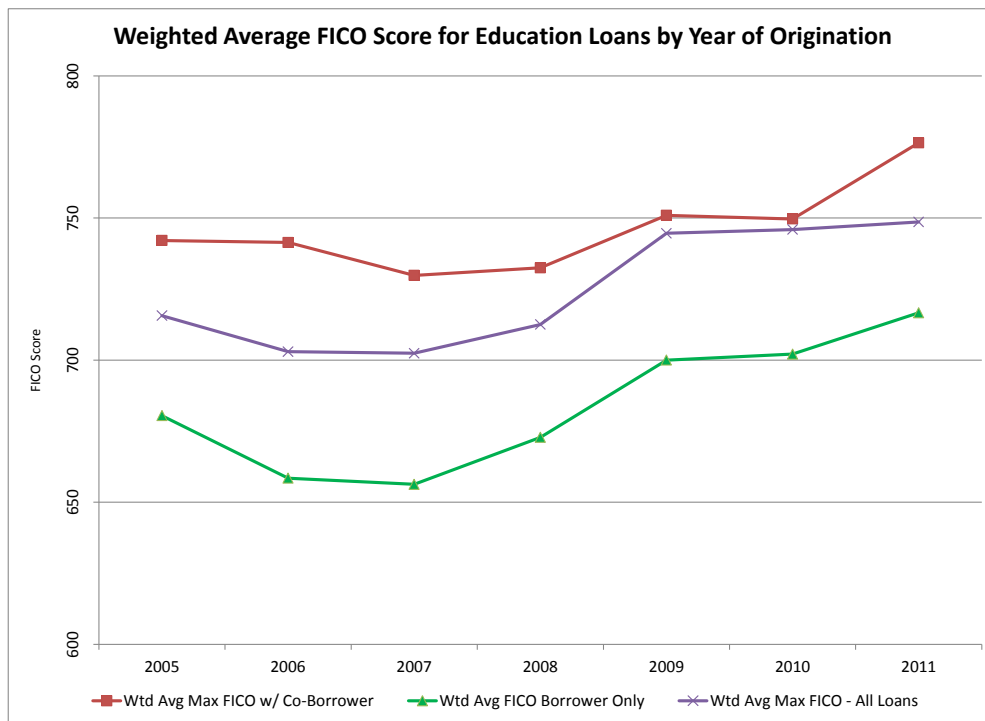
would suggest that PSL amounts should have grown during the recession, when they in fact declined after 2007.

There is reason to infer that the spike in loan amounts was driven primarily by changes in the level of school monitoring of the loan process (due to a sidestepping of the financial aid office with the rise in DTC lending). In addition, the dramatic increase in individual annual loan amounts relative to tuition and fees reflects additive borrowing; students were borrowing more from Direct-to-Consumer lenders while maintaining other financial aid sources, that is, over-borrowing (borrowing more than the Expected Family Contribution) when schools were not providing controls on loan amounts. This comports with the fact that, absent school certification, lenders have no way of knowing what other debt aid the student has already incurred for the academic year. As school certification started to rebound in 2008, the proportion of total costs of education that students funded through PSLs fell precipitously.

### **DEMAND CREATES SUPPLY, REVISITED: CREDIT STANDARDS WEAKEN AS LOAN VOLUMES RISE.**

During the securitization boom, the SLABS market was similar to the residential mortgage-backed securities market in another respect: credit criteria. The demand for PSL assets to fuel SLABS issuance provided incentives to increase approval rates by lowering minimum credit scores and muted incentives to increase the percentage of creditworthy borrowers in a loan pool. Figure 8 shows the weighted average FICO scores of borrowers for loans in our sample, illustrating a general move to less creditworthy borrowers during the securitization and lending boom. Figure 8 presents FICO scores weighted by real original balances for educational loans, demonstrating that weighted average FICOs from 2005 to 2011 varied by as much as 40-60 points as credit standards first dipped and then, after the financial crisis, rapidly increased.

**FIGURE 8: WEIGHTED AVERAGE FICO SCORES BY CALENDAR YEAR  
(SAMPLE LENDERS)**

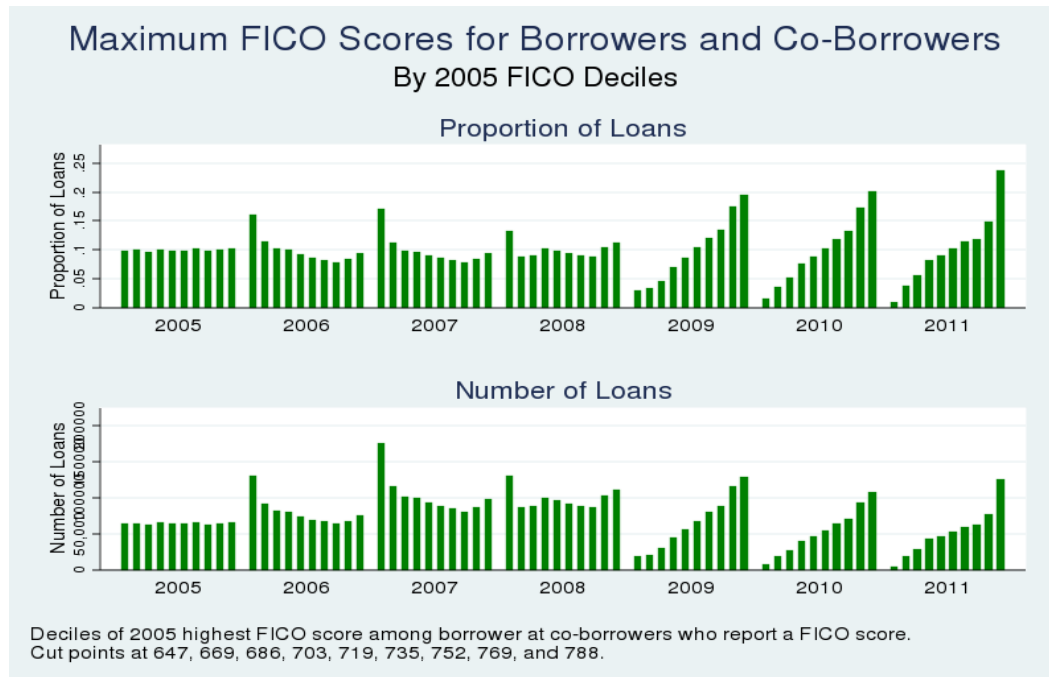


Source: Sample Lender loan level data

The "weighted average max FICO" shows the average of the highest FICO where there are two or more borrowers with FICOs on a loan,<sup>48</sup> the weighted average borrower-only FICO shows the average of loans with only one signer, and "all loans" averages the two.

Figure 9, below, presents the change in educational loan volumes both as a proportion of all loans and as counts of loans for borrowers in each of the deciles of FICO scores for borrowers in the Sample Lender loan level data in 2005. During the boom years, the lowest credit deciles were the most heavily populated. After the financial crisis, the distribution reversed. Simply put, during the boom, lenders made a high percentage of loans to weaker credits. Today, only a very good credit is likely to be approved:

**FIGURE 9: FICO DISTRIBUTION BY 2005 DECILES (SAMPLE LENDERS)**



Source: Sample Lender loan level data

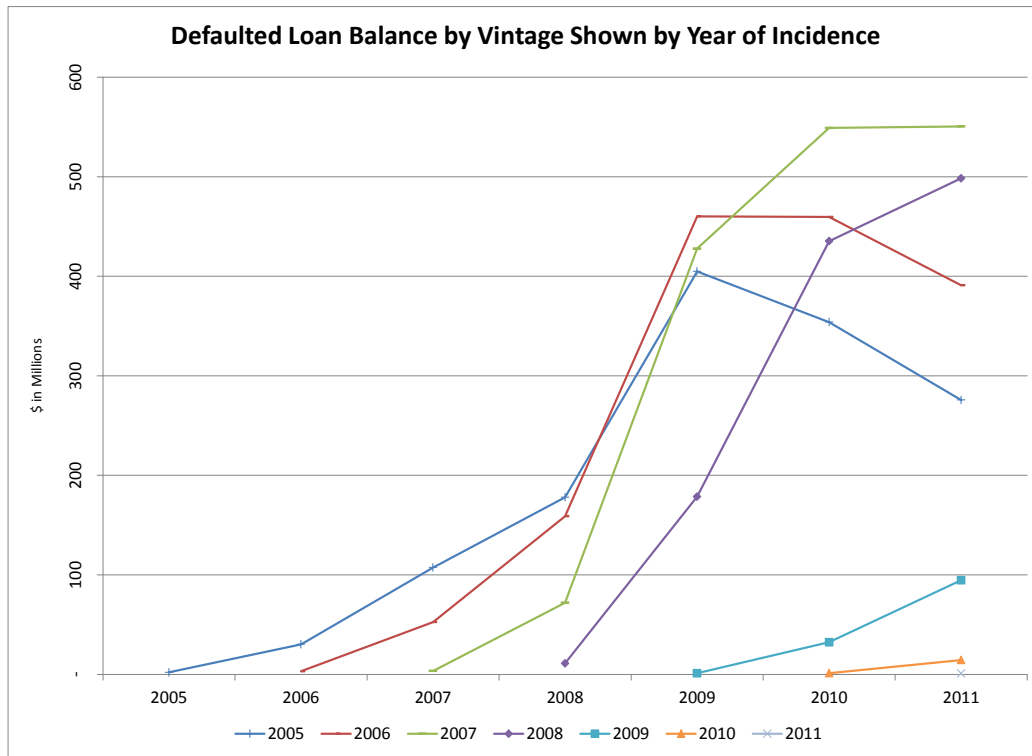
To summarize, during the SLABS boom the size of the PSL market doubled through a combination of over-borrowing and a marked decline in credit standards. Both of those trends created consumer risks at the same time that they created risks to lenders (or the investors holding the loans); both consumers and creditors lose when loans cannot be repaid.

## DISLOCATION IN THE CAPITAL MARKETS CAUSES A SIGNIFICANT CONTRACTION IN THE SECONDARY MARKET

As described in Figure 5, the SLABS market dropped to \$1 billion in 2008. Excluding government-assisted transactions, 2009 and 2010 volumes were \$2.9 billion and \$5.4 billion, respectively.<sup>49</sup> In 2011, securitization levels declined to \$3 billion. SLABS transactions are no longer immediately profitable for lenders, meaning fewer lenders rely on them as a funding source.<sup>50</sup>

Starting in 2008, as illustrated in Figure 10, banks and investors incurred sharply increased defaults on loans made during the lending boom. The timing of these defaults appears to track the recession, but the volume within cohorts may also be related to over-borrowing and the level of subprime credits in cohorts like 2007.

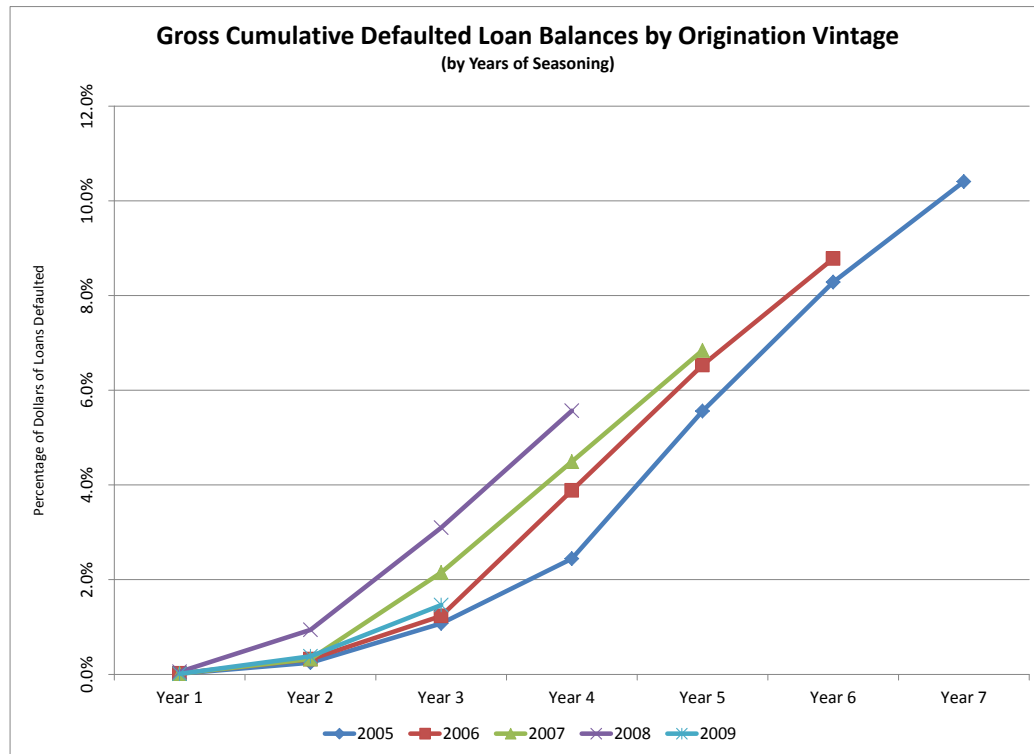
**FIGURE 10:** GROSS DEFAULTS BY TIME INCIDENCE - SAMPLE LENDER PORTFOLIO (X AXIS IS CALENDAR YEAR)



Source: Sample Lender loan level data



**FIGURE 11:** (BASED ON \$'S) GROSS CUMULATIVE DEFAULT CURVES BY ORIGINATION VINTAGE (2005-2009) BY YEARS OF SEASONING (SAMPLE LENDERS)



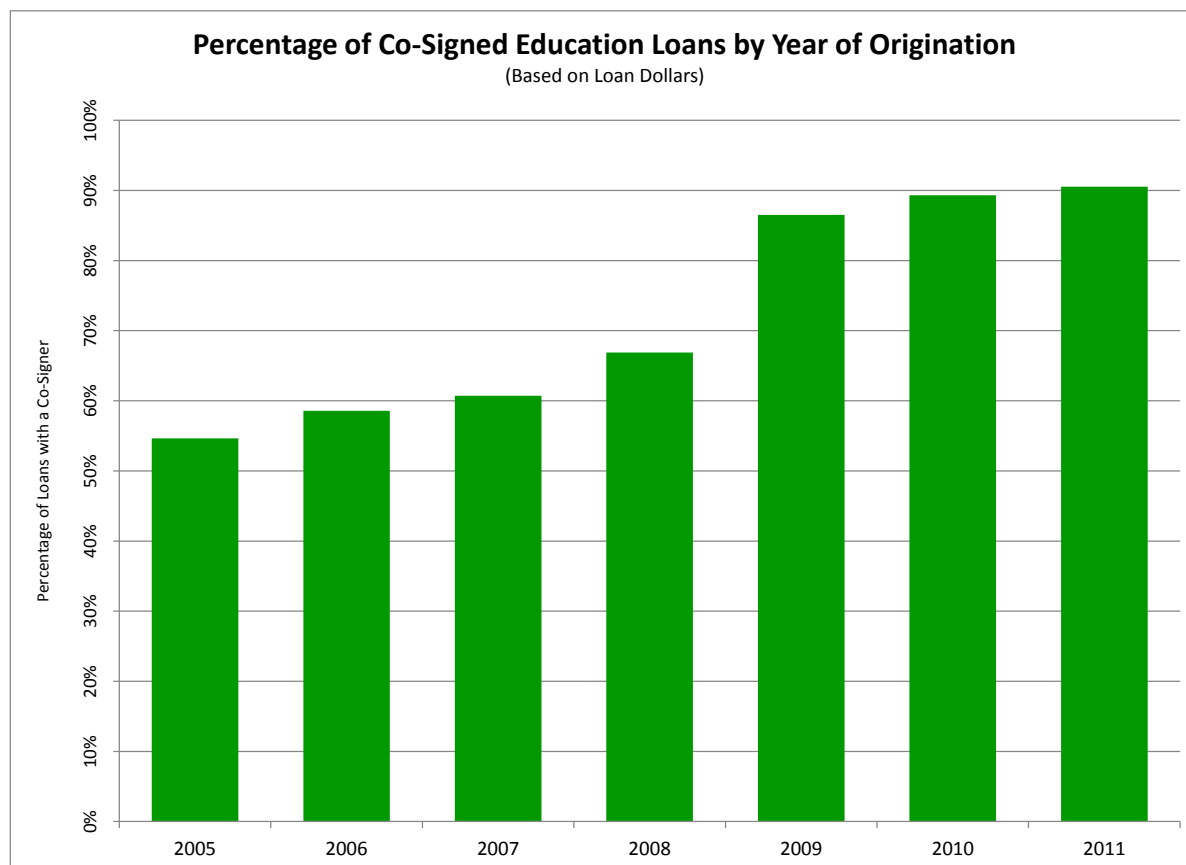
Source: Sample Lender loan level data

The default curves for the 2005-2008 vintages in the Sample Lender Portfolio data show increasing loss rates for each successive vintage, reflecting increasingly aggressive underwriting. Notably the 2009-2010 vintages do not show the steep trajectories of earlier years. The foregoing are data from the Sample Lender Portfolio. In reviewing the portion of these loans that were securitized, the ABS analysts and the issuers appear to agree that the credit quality of Direct-to-Consumer (i.e., not school-certified) lending in 2005-2008 was materially worse than average.<sup>51</sup> All of the ABS issues from the issuers with large DTC percentages have been downgraded,<sup>52</sup> meaning that the agencies that rate the credit quality of the bonds have determined that the SLABS backed by loans from those lenders have a relatively high risk of loss, because the underlying loans have a relatively high risk of default compared to the assumptions used when the bonds were originally issued.

## POST-CRISIS, LENDERS REPORT A FLIGHT TO QUALITY IN PSL UNDERWRITING.

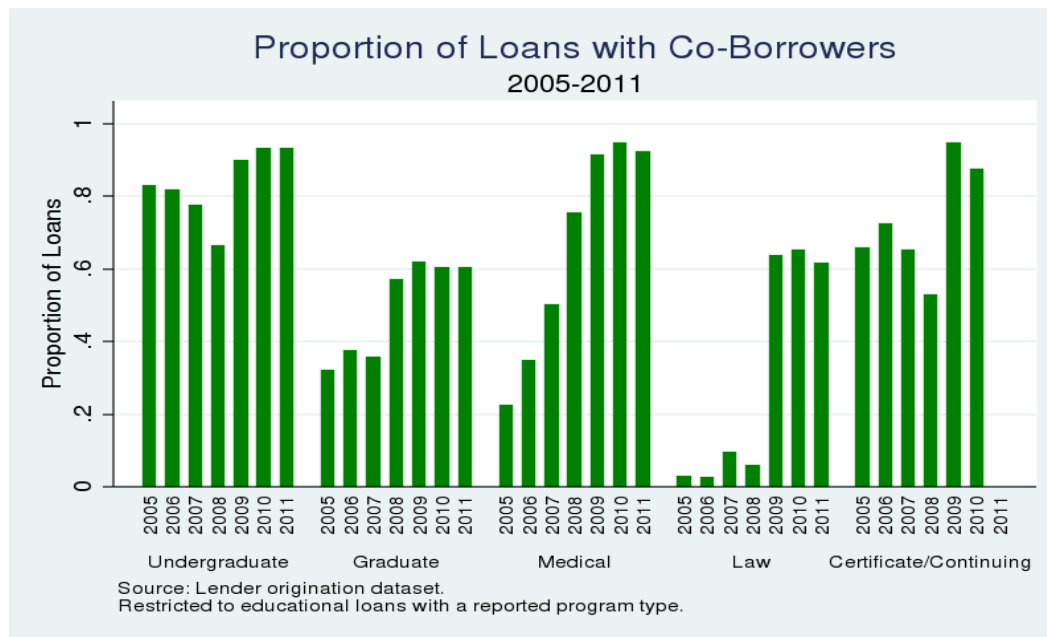
The sample lenders report in their qualitative description of underwriting changes that they have taken a number of measures to improve credit quality since 2008. As illustrated in Figure 12 and Figure 13, the proportion of loans that are co-signed has increased over the sample period; by 2011, 90.5% of the dollar volume of educational loans originated by the sample lenders was co-signed, compared to 55% in 2005. Adding a co-signer provides a margin of safety for both lender and borrower. The benefit to the lender is obvious. For the student borrower facing today's difficult labor market, a co-signer can provide a payment bridge if the student struggles financially.

**FIGURE 12: PERCENTAGE OF CO-SIGNED EDUCATION (NON-CONSOLIDATION) LOANS FROM 2005 - 2011 (SAMPLE LENDERS)**



Source: Sample Lender loan level data

**FIGURE 13:** PROPORTION OF LOANS WITH CO-BORROWERS BY PROGRAM TYPE



Source: Sample Lender loan level data

With respect to increases in the level of co-signing, lenders were seeking to mitigate risk as they expanded access to credit throughout the reporting period; however, we note that this trend accelerated between 2008 and 2009, as falling investor demand for SLABS both reduced the size of the PSL market and forced lenders to retain the bulk of their production for their own loan portfolios.

In addition, mean FICOs have increased and the distribution now shows peaks in the upper credit tiers and relatively few low score loans. See Figures 8 and 9, above. School certification is now at its highest level since the beginning of the Sample Lender Origination dataset (see Figure 6). Lenders also report returning to the practice of disbursing funds to schools instead of to borrowers.

To summarize, the Sample Lender Portfolio and loan-level data illustrate a credit boom that led to lax underwriting standards on a number of dimensions and a bust that has led to a significant tightening of those underwriting standards.

### **THE CURRENT STATE OF PRODUCT TERMS: INCREASED RATE RISK AND INCREASED REGULATION OF INFORMATION PROVIDED BY SCHOOLS.**

The historical interest rates of PSLs and the margin over variable rate indices are shown in Appendix Figures 2, 3 and 4. Appendix Figure 2 shows initial interest rates moving up with the credit crisis in 2007-2008, for all education programs, and down with the general rate environment in 2009. As lenders sought out primarily excellent credit from co-signers, the range from high to low rates contracted. Tellingly,

Appendix Figures 3 and 4 show that margins (which are added to the index to produce the variable rate) increased rapidly in 2007-2008, but did not subsequently decline as much as initial rates declined. As shown in Appendix Figure 4, the persistence of higher margins is not attributable to lenders changing the overall mix of index rates, but to an increase in margins added to each index rate. To a significant degree, the recent reduction in initial variable rates advertised by PSL lenders is more a factor of today's extremely low general interest rate environment than it is of loan terms returning to pre-crisis levels.<sup>53</sup> Today's PSLs have more embedded (and asymmetric<sup>e</sup>) rate risk than PSLs in 2005. Figure 3, above, shows the combined effect of rate variation over time and the relatively high margins currently used to compute variable rates. Even in the current extremely low rate environment, only the best credits receive PSLs with rates below the unsubsidized Stafford interest rate.

Marketing channels for PSLs have also changed, possibly due in part to changes in laws and regulations. The return to school-certified lending has not been paralleled by a return to school sourcing of borrowers. Many lenders continue to find borrowers through direct marketing to existing banking customers, involving the school only after loan approval, to verify financial need.<sup>54</sup>

Schools are well-positioned to influence financial decision-making by students. This has often attracted scrutiny from the public and regulators. For example, many financial institutions arrange marketing partnerships with schools to attract students to credit card, deposit account, and financial aid disbursement card products. Financial institutions have also pursued arrangements to attract borrowers for PSL products.

Prior to the changes to the Higher Education Act under the Higher Education Opportunity Act of 2008 ("HEOA") and subsequent Department of Education regulations, there were numerous reports of inappropriate relationships between schools and lenders that reflected inducements given to, and in some cases solicited by, schools for placement on an institution's preferred lender list. These relationships were exposed in investigations by the New York Attorney General and the United States Senate. Documentation of these practices obtained through these investigations reflected direct compensation to institutions, travel and accommodation for "advisory board" meetings hosted by lenders, and school financial aid officials receiving stock and stock options from lenders on the preferred lender list. The Investigations by the Iowa Attorney General also revealed that its state-affiliated PSL provider inappropriately steered students towards higher cost loan products, and provided payments to participating colleges encouraging use of their PSL product.<sup>55</sup>

A number of Public Commenters suggest that provisions of the HEOA imposed excessive restrictions on schools who choose to provide information about PSLs to students or parents. These changes established code-of-conduct requirements relating to the selection of "preferred lenders" (including imposing quasi-fiduciary duties) and required the postsecondary institution to provide disclosures designed to ensure, if the

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<sup>e</sup> As interest rates cannot become negative, and generally PSL notes have no rate caps, interest rates can potentially increase more than they can decrease.

school chooses to refer students to a lender, that students and families have the information to determine whether the institution conducted a fair selection process that was free from conflicts of interest.<sup>56</sup> Comments from schools, lenders and advocacy groups all noted that a majority of schools are concerned about recommending lenders under the preferred lender rules, and many refuse to provide any information about PSLs.<sup>57</sup> Many school commenters complained of the burden of the regulations and stated that students receive less information about lending options as a result of the rules. The public commenters, however, have not suggested alternative safeguards to avoid repetition of those inappropriate relationships and associated market failures that would be less restrictive than current marketing rules.

In addition to complaints about the rigors of the new “preferred lender list” rules, schools also expressed concern that the 2008 law changes interfere with delivery of federal loan options that may not be viewed by the public as “private student loans,” even though they are defined in the statute as such. Under the 2008 amendment to TILA, the term “private student loan” includes any loan not made or insured under Title IV of the HEA, such as health professions loans administered by the Department of Health and Human Services.<sup>58</sup> As a result, preferred lender list requirements and special TILA disclosures even apply to some loan programs established by Congress. The result is confusing disclosures and an added burden on schools to deliver another federal loan program. For example, the special disclosures for federal health professions loans include several admonitions to exhaust federal loan options first (before taking a federal loan).<sup>59</sup>

To summarize, PSLs (offered by financial institutions) have become more risky with respect to interest rates and many schools have reported that they find it more difficult to provide information about PSLs under current statutory requirements.

## **C. NON-BANK PSL PROVIDERS**

As explained at the beginning of this Report, for-profit (bank) lenders make up \$6 billion of today’s \$7.9 billion PSL market. The balance is provided by state-affiliated non-profit lenders and by the schools themselves (directly or through school-supported investment funds).

### **NON-PROFIT, STATE-AFFILIATED LENDERS GREW DURING THE SECURITIZATION BOOM AND CAPITAL MARKETS RESTRICTIONS HAVE SINCE CUT THEIR VOLUME.**

Ten state-affiliated non-profit private loan providers volunteered to provide data for this study. These lenders provide approximately \$950 million annually in loans for residents of their states and out-of-state students attending in-state schools. The state program providers report that their loans are distinguished from for-profit lenders in a number of ways, including lower, fixed rates derived from tax-advantaged bond funding, lack of risk-based pricing, substantial financial counseling before and after

borrowing, and 100% school certification. To learn more about these loans, the Agencies obtained voluntary submission of data from state-affiliated lenders.

Non-profit lenders submitted loan origination volume history set forth below in Table 1. The Agencies believe this sample to be representative of approximately 50-60% of the aggregate size of the non-profit, state-affiliated loan market.

**TABLE 1: SELF-REPORTED LOAN VOLUMES OF STATE-AFFILIATED NON-PROFIT LENDERS**

**Sample of Non-Profit/State-Affiliated Private Student Loan Originations by Academic Year  
Dollars in Millions**

2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
\$533.9	\$764.9	\$1,005.7	\$584.0	\$552.2	\$600.6

Source: State Lender data

As evidenced by the table above, non-profit, state-affiliated programs experienced a significant curtailment in originations beginning with the 2008-2009 academic-year cohort; originations fell 39% between 2008 and 2009. Growth returned in the 2010-2011 academic year. Because the nature of the data available for this set of lenders differs from that of the financial institution lenders from both a qualitative and quantitative perspective, it is difficult to draw conclusions about the causes for such declines and growth.

Similar to financial institutions, non-profit state-affiliated lenders leveraged the availability of capital in the secondary markets, specifically by issuing SLABS.<sup>60</sup> While the structures of the financing vehicles utilized by non-profit lenders during the boom years differed slightly from for-profit structures (i.e. revenue bonds versus senior/subordinate tranches of taxable debt), non-profit, state-affiliated lenders were impacted by the lack of investor demand for SLABS as well.<sup>61</sup> Most of the student loan backed bonds issued by non-profit, state-affiliated lenders are tax exempt and therefore have a funding advantage over for-profit SLABS securities for certain investors, but even tax-advantaged investments were curtailed during the financial crisis of 2008.

**NON-PROFIT, STATE-AFFILIATED LENDERS CLAIM TO PROVIDE A LOWER-RISK, MORE CONSUMER-FRIENDLY PRODUCT, AND THE LIMITED AVAILABLE FACTS APPEAR TO SUPPORT THESE CLAIMS**

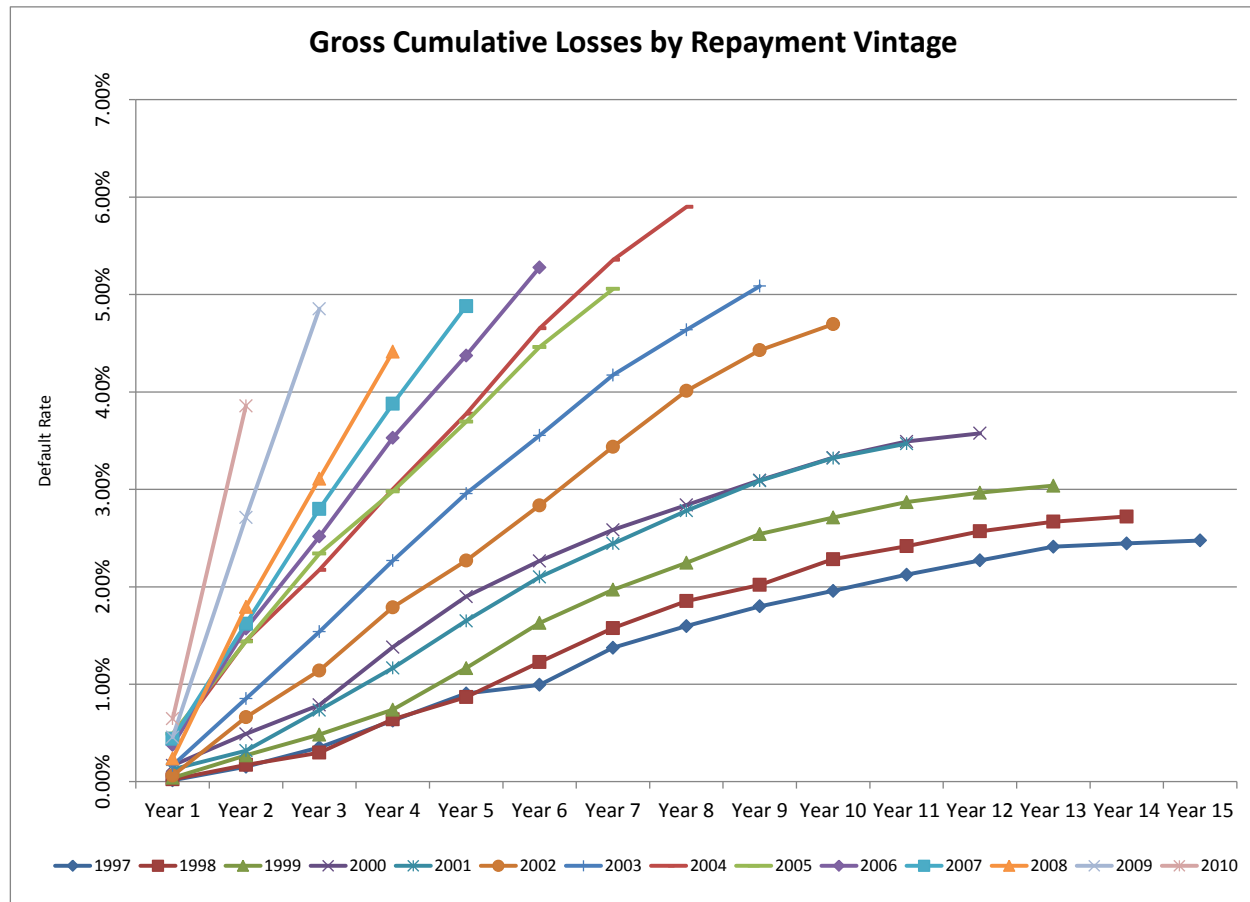
Non-profit, state-affiliated lenders claim to achieve lower risk to consumers due to consumer education, not using risk-based pricing, using fixed rates in most cases, providing more repayment options, requiring all loans to be school certified, and

having a general mission to benefit the public. One non-profit, state-affiliated lender's Public Comment included detailed information about online financial counseling required to be completed by borrowers and their co-signers prior to even applying for a loan. The lender reported that a significant number of borrowers who completed the counseling reduced their loan amount request.

Five state-affiliated lenders provided extensive historical loan interest rate data. Every lender had a long history of offering single fixed-rate products, without using risk-based price tiers. Using a single interest rate, for borrowers with a range of credit characteristics, averages credit risk across all borrowers and gives borrowers with weaker credit lower pricing than they would receive in an individual risk-based pricing regime. Interest rates prior to the financial crisis ranged from 6.0% to 7.5%. After the crisis, more stringent credit and funding requirements in the ABS market increased prices by approximately 200 basis points.

Default rates for non-profit, state-affiliated lenders in our data set are approximately half that of their for-profit market counterparts in our Sample Lender loan level database. Underwriting data from a portion of our sample suggests that more careful underwriting (relative to financial institution lenders) reduced default rates. Figure 14, below, shows the lifetime gross cumulative loss curves from 1997 through 2010 for a select group of lenders who submitted their loan performance data for this study. Non-profit lenders also exhibit much higher recovery rates on defaulted loans, reflecting both conservative credit underwriting and special collection tools available to some (such as garnishing state tax refunds). Figure 14 shows data for loans going into repayment for five lenders who elected to provide data.

**FIGURE 14:** GROSS CUMULATIVE DEFAULTED DOLLAR CURVES BY REPAYMENT ENTRY VINTAGE (1997-2010) BY YEARS OF SEASONING FOR FIVE NON-PROFIT LENDERS



Source: State Lender data

Please note that the data presented above is reported on a different basis than the financial institution lender loss curves presented in Figure 11. The above data is presented by year of repayment entry, not year of origination.

The Agencies were unable to obtain comprehensive data regarding default avoidance and cure options available to borrowers under the state-affiliated programs. As noted above, federal student loans provide comprehensive borrower protection through repayment options both before and after default. In response to questions on this issue, some state-affiliated lenders indicated that capital markets funding for their loans limited their flexibility in providing repayment protections to borrowers.



# INSTITUTIONAL LENDING

## **LITTLE IS KNOWN ABOUT INSTITUTION-FUNDED LENDING AT NON-PROFIT SCHOOLS.**

There is very little verifiable quantitative data about PSLs made directly by schools. According to the College Board, total institutional loan volume is estimated to be approximately \$720 million in the 2010-2011 academic year, as compared to \$500 million in the 2007-2008 academic year.

Public Comments paint a consistent picture of institutional lending. Many schools offer payment plans to spread out costs over 12 months.<sup>62</sup> Many institutional loan programs are designed to emulate the Perkins Loan program, which are federally financed loans offered through and originated by schools.

Perkins loans have a low fixed rate and an interest subsidy during enrollment. Institutional loans are usually loans of last resort, offered when the student has exhausted all other sources. As such, institutional loans are not based on ability to repay – a creditworthy student would be sent to a bank. The Agencies were not able to verify these assertions, but note that the approximately 2,000 consumer Public Comments do not contain significant evidence that would give rise to a concern about institutional lending by non-profit private or public colleges and universities.

## **PSL LENDING AT FOR-PROFIT SCHOOLS HAS MOVED FROM BANK FUNDING TO SCHOOL FUNDING, AND SHOWS EVIDENCE OF RISK ASSOCIATED WITH THAT SHIFT.**

Proprietary, or for-profit, college institutional loans deserve separate discussion. As shown in Table 6, in Part Two, students at for-profit schools add PSLs to their debt mix at roughly twice the rate of students in comparable non-profit programs. For example, in 2007-2008 46% of students at for-profit 4-year schools borrowed a PSL, compared to 25% of students at private non-profit 4-year schools. However, private student loan availability for proprietary school programs was significantly reduced (on a percentage basis) during and after the financial crisis of 2008, more significantly than other school types.<sup>63</sup>

Many lenders pulled back from the proprietary sector due to the perceived risk of making loans to students in these schools/programs.<sup>64</sup> Indeed, empirical evidence from some lenders points to students at proprietary colleges having lower completion and graduation rates, as well as increased rates of default on private student loans (and federal student loans, too).<sup>65</sup> When bank-funded private student loans became unavailable to students at for-profit schools, some proprietary programs began lending directly to their students in response. According to SEC filings for select publicly traded for-profit education providers, some of these schools have turned to third party administered private student loan programs.<sup>66</sup> In some of these third party arrangements, the school provides credit enhancement to one or more lenders. In one instance, a school provides credit enhancement to a trust that purchases loans specifically for only this school. The school buys the subordinated bonds issued by the

trust and, in addition, explicitly guarantees the principal obligations of the senior bonds of the trust.<sup>67</sup> Public filings by these for-profit schools suggest they anticipate losses resulting from default rates on these quasi-institutional loans that are significantly higher than those experienced in bank or non-profit PSL programs. For example, Corinthian Colleges Inc. reported on its fourth quarter 2009 earnings call that it would have to discount its institutional loans by 55 percent.<sup>68</sup>

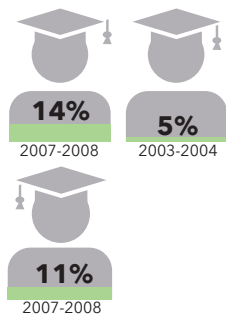
# Part Two: Borrower Characteristics and Behaviors

## **PSL BORROWERS AND THEIR REPAYMENT BEHAVIORS**

In response to Congress' mandate in the Act, the Agencies compiled information on the characteristics of PSL borrowers and on the repayment behavior of former students who were PSL borrowers. Many of the findings below are in accord with what might be expected; in general, student borrowers are young and come from families that are not wealthy.

Information on borrower characteristics comes from the 2008 and 2004 iterations of the National Postsecondary Student Aid Study (NPSAS:08 and NPSAS:04), a nationally representative survey of postsecondary students, including graduate and first-professional<sup>69</sup> students, conducted approximately every four years. Information on repayment behavior and employment comes from the 2004/2009 Beginning Postsecondary Students Longitudinal Study (BPS:04/09), a longitudinal survey that follows a subset of NPSAS respondents who began their postsecondary education during the 2003-2004 academic year. These datasets bring together detailed administrative and survey data in a longitudinal context.

KEY FINDINGS ABOUT PSLs BORROWING IN THE 2007-2008  
ACADEMIC YEAR INCLUDE:



**14%** OF UNDERGRADUATES HAD PSLs, COMPARED TO  
ONLY 5% THAT HAD PSLs IN THE 2003-2004 ACADEMIC YEAR.<sup>70</sup>

**11%** OF GRADUATE AND FIRST-PROFESSIONAL STUDENTS  
USE PSLs.<sup>71</sup>



MOST UNDERGRADUATE PSL BORROWERS ALSO APPLIED FOR FEDERAL FINANCIAL AID;

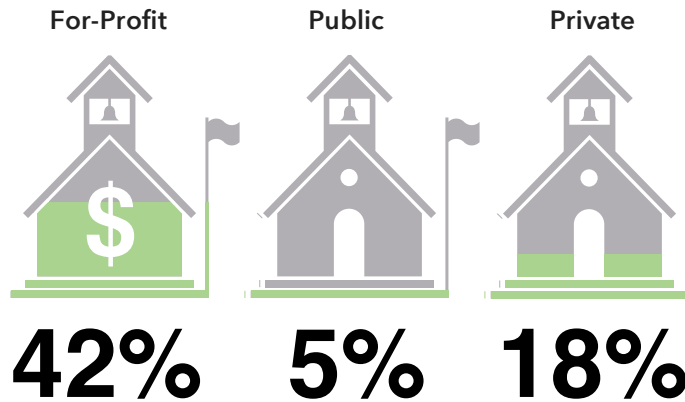
**12%** DID NOT APPLY.<sup>73</sup>

AMONG DEPENDENT UNDERGRADUATES WHO HAD PSLs,

PSL amounts were higher for individuals in higher family income quartiles. Individuals in the lowest quartile had average PSL loan amounts of \$5,643 while individuals in the top quartile had average PSL loan amounts of \$9,299.<sup>74</sup>

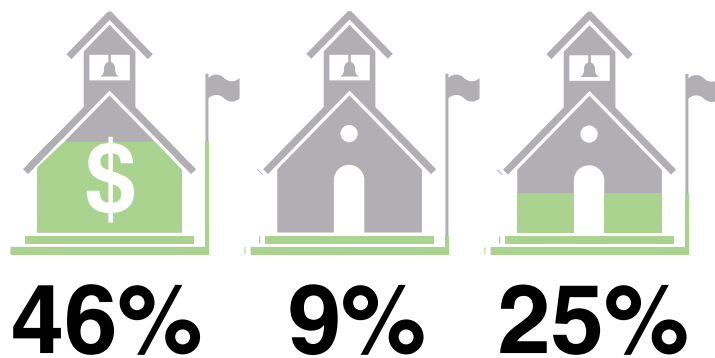
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PSL USAGE WAS MORE PREVALENT AMONG STUDENTS AT FOR-PROFIT SCHOOLS THAN AMONG THOSE WHO ATTENDED PUBLIC OR PRIVATE, NON-PROFIT SCHOOLS.



**AT TWO-YEAR SCHOOLS,**

42% of students attending for-profit institutions had PSLs, while 5% of students at public institutions had PSLs and at private, not-for-profit institutions, 18% of students had PSLs. At for-profit two-year institutions, 96% of students who had PSLs also had federal loans.



**AT FOUR YEAR SCHOOLS,**

46% of students at for-profit institutions had PSLs, compared to 9% of students at public institutions and 25% of students at private not-for-profit institutions. At for-profit four-year institutions, 97% of students with PSLs also had federal loans.<sup>75</sup>

KEY FINDINGS ABOUT THE 2009 REPAYMENT BEHAVIOR AND  
EMPLOYMENT STATUS OF PSL BORROWERS WHO ENTERED  
POSTSECONDARY EDUCATION IN 2003-2004 INCLUDE:

**63%** had total monthly student loan payments (for both private and non-private loans) that were less than 5% of their monthly income and

**80%** have monthly student loan payments less than 10% of their income.

**5%** had monthly student loan payments of 25% or more of their monthly income.<sup>76</sup> That group increased to ten percent for graduates who attained a bachelor's degree.

Among PSL borrowers who also had federal loans, a higher proportion of individuals who started their postsecondary education at 2-year for profit institutions (18%) defaulted on their PSLs than those who started at 2-year public institutions (5%).<sup>77</sup>

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THE UNEMPLOYMENT RATE AMONG PSL BORROWERS WAS **16%**; FOR PSL BORROWERS WHO ATTAINED A BACHELOR DEGREE THE UNEMPLOYMENT RATE WAS **11%**.<sup>78</sup>

Mean incomes in 2009 did not differ significantly between PSL borrowers and individuals who were not PSL borrowers but who were part of the same student cohort. This held within levels of educational attainment, as well as by type of institution first attended.

## PREVALENCE OF PSL BORROWING

Table 2 shows the share of undergraduates that used PSLs in the 2007-2008 academic year. It shows that 14% of undergraduates had for-profit private student loans and less than 1% had either institutional or state loans. The majority of students who borrow have federal loans:<sup>79</sup> of the 39% of undergraduates who had an educational loan in the 2007-2008 academic year, 90% had a federal loan.<sup>80</sup> Also, as shown in Table 6 below, exclusive use of PSLs as a source of borrowing is uncommon; 4% of undergraduates have PSL as their only form of borrowing in the 2007-2008 academic year. More students used a combination of federal and private loans: 11% of undergraduates used both PSLs and federal loans in the same academic year.

**TABLE 2: PRIVATE LOAN USAGE BY UNDERGRADUATES, 2007-2008  
ACADEMIC YEAR**

	Private Loans	Institutional Loans	State Loans
	(%)	(%)	(%)
Total	14.2 (0.20)	0.5 (0.09)	0.4 (0.03)
Institution Type			
Public	8.7 (0.17)	0.3 (0.05)	0.4 (0.03)
Private Not-for-Profit	24.3 (0.54)	1.1 (0.16)	0.7 (0.11)
Private For-Profit	42.5 (1.17)	1.2 (0.76)	0.1 (0.04)

Source: NPSAS 2008.

Standard errors in parentheses.

The names of the variables used in this table are: CONTROL, STLNAMT, PRIVLOAN and INLNAMT.

The weight variable used in this table is WTA000.

Consistent with the increase in PSL loan originations from 2005-2008 in the sample lender loan-level data, the share of undergraduates and graduate students who have PSLs is statistically significantly higher<sup>81 82</sup> in the 2007-2008 academic year than in the 2003-2004 academic year. Tables 2 and 4 show that 14% of undergraduates used PSLs in 2007-2008, compared to 5% in 2003-2004.<sup>83</sup> For graduate students the percentages were 11% and 7%, respectively, as shown in Table 3.<sup>84</sup> In contrast, among first professional students, use of private student loans was significantly higher in 2003-2004 than 2007-2008,<sup>85</sup> which is consistent with the timing of the increase in federal loan limits for first-professional students to \$20,500 as of July 1, 2007 in the Higher Education Reconciliation Act of 2005 (P.L. 109-171).

**TABLE 3:** GRADUATE STUDENT PARTICIPATION IN LOAN PRODUCT TYPES , 2007-2008 ACADEMIC YEAR AND 2003-2004 ACADEMIC YEAR

	2007-2008 Academic Year				2003-2004 Academic Year			
	Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)	Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)
Total	3.5 (0.29)	32.0 (0.50)	7.2 (0.49)	57.3 (0.30)	1.7 (0.18)	32.9 (0.96)	5.4 (0.46)	60.0 (1.16)
Master's Degree	3.9 (0.42)	32.1 (0.80)	7.5 (0.77)	56.4 (0.60)	1.9 (0.25)	32.7 (1.31)	3.6 (0.47)	61.7 (1.46)
Doctoral Degree	2.0 (0.41)	24.5 (1.26)	5.2 (1.36)	68.2 (1.49)	1.3 (0.28)	23.3 (1.49)	3.6 (0.49)	71.7 (1.49)
First-Professional Degree	1.7 (0.41)	63.1 (2.24)	13.9 (0.91)	21.3 (1.65)	2.1 (0.45)	51.9 (2.13)	20.7 (2.10)	25.4 (1.84)
Post-BA or Post- Master's Certificate	4.4 (1.34)	21.2 (2.39)	4.4 (1.14)	70.0 (3.03)	0.7 (0.50)	27.7 (5.05)	1.7 (0.66)	69.9 (4.71)
Not in a Degree Program	4.0 (2.25)	13.2 (2.12)	1.8 (0.44)	81.0 (3.27)	1.1 (0.35)	25.4 (4.05)	1.6 (0.68)	72.0 (4.18)

Source: NPSAS 2008 and NPSAS 2004.

The names of the variables used in this table are: PRIVPACK and GRADDEG.

The weight variable used in this table is WTA000.

Standard errors in parentheses.



# CHARACTERISTICS OF UNDERGRADUATE BORROWERS

This section describes the characteristics of undergraduate borrowers of PSLs and non-private student loans. When considering the results in this subsection it is important to note that these are “univariate” statistics; they do not take into account factors that may explain differences between groups, such as differences in average income between students whose parents have different educational attainment.

## DEMOGRAPHIC CHARACTERISTICS

Table 4 shows undergraduate loan usage by demographic characteristics.

### GENDER

The proportion of men and women who have a combination of federal and private student loans is around 10%, and while there is a small but statistically significant higher proportion of women (11%) who have a combination of private and non-private loans than men (10%);<sup>86</sup> this difference is not economically significant. There is also no significant difference between the proportion of men and women who have only PSLs.<sup>87</sup>

### AGE

PSL usage is highest amongst students aged 19-29. While estimates of exclusive PSL usage are below 5% for all age groups in 2007-2008, it is more prevalent among individuals in the 19 to 23 year old age range (colloquially referred to as traditional age college students) and those in the 24 to 29 year old age range.<sup>88</sup> For these two groups, the percentage of students who use PSL exclusively is 4%. Similarly, usage of a combination of PSL and non-private loans is higher among students age 19 to 23 and age 24 to 29 versus students 18 or younger and students 40 and older, and the difference between the proportion of students who use a combination of PSLs and non-private loans in the 19 to 23 age range and the 24 to 29 age range is not statistically significant.<sup>89</sup>

### RACE

In the 2007-2008 academic year, although the frequency of the exclusive use of private student loans does not vary by racial group, a higher percentage of African Americans (14%) use a combination of federal and private loans than all other racial groups.<sup>90</sup> As a point of comparison, 11% of whites use a combination of PSLs and non-private loans as do 5% of Asians, the group with the lowest usage of a combination of PSL and non-private loans.<sup>91</sup> This pattern did not hold in 2003-2004, when the proportion of white students with a combination of private and federal loans (4%) was statistically significantly higher than the proportion of African Americans (3%).<sup>92</sup>

## FAMILY CHARACTERISTICS

Table 5 shows loan usage by family characteristics, including parental education, Census region of permanent residence, dependency status, and family income.

### DEPENDENCY STATUS

PSL usage is significantly lower among independent students than dependent students, although the differences may not be considered large in magnitude: 3% of independent students use PSLs exclusively versus 4% of dependent students,<sup>93</sup> and 10% of independent students use a combination of PSL and non-private loans versus 11% of dependent students.<sup>94</sup> When considering these results, one should keep in mind that this does not account for age, attendance intensity, or parental status.

### REGION OF PERMANENT RESIDENCE

Private student loan usage varies by Census region of permanent residence: 20.2% of students whose permanent residence is in the Northeast utilize PSLs while 9.6% of students from the West have PSLs (the lowest proportion by region), and this difference is statistically significant.<sup>95</sup>

### PARENTAL EDUCATION

Parental education may affect use of PSLs and other loan products for a variety of reasons, including parental awareness of federal aid programs from their own college experiences, higher willingness-to-pay for education, and higher incomes due to higher education which may lead to more available income and savings to finance education. Private student loan borrowing is less prevalent among students whose parents have a bachelor's degree or post-graduate degree than other groups, and is less prevalent for students whose parents have post-graduate degrees than students whose parents have only bachelor's degrees.<sup>96</sup>

With regards to the use of PSLs, Table 5 shows that there is no significant difference in exclusive PSL usage by parental educational attainment.<sup>97</sup> The proportion of students who use a combination of PSL and non-private loans does not differ significantly for individuals whose parents' highest level of educational attainment is high school or less, college attendance without attaining a degree, an associate's degree, or vocational training.<sup>98</sup> The proportion of students who have a combination of PSL and non-private loans whose parents have a bachelor's degree is significantly lower than for students whose parents have a high school degree or less<sup>99</sup> or an associate's degree,<sup>100</sup> and not significantly lower than for students whose parents attended college but who do not have a degree.<sup>101</sup> The proportion of students who have private and non-private loans whose parents have post-graduate degree is lower than for all other groups.<sup>102</sup>

### PARENTAL INCOME

The incidence of PSL borrowing, which is calculated by summing the column of students who only have private loans and the column of students who have both private and non-private loans, varies by parental income, and is highest in the middle two quartiles of the income distribution: 15% in the 2<sup>nd</sup> quartile and 16% in the 3<sup>rd</sup>

quartile, versus 14% in the lowest quartile and 11% in the top quartile.<sup>103</sup> Figure 15 presents loan amounts by income quartile for students who have loans in the specified categories, restricted to borrowers who were dependents in the 2007-2008 academic year. In the figure, PLUS loans are considered federal loans. The results in Figure 15 demonstrate that loan amounts are higher in higher income quartiles for dependent students for both PSL and federal loans. When considering these results, it is important to take into account that subsidized Stafford loan limits decrease as family income increases, which may explain why the average subsidized Stafford loan amount does not increase across income quartiles.

## **SCHOOL AND PROGRAM CHARACTERISTICS**

Table 6 shows use of particular loan types by school and program characteristics including type of institution attended, attendance intensity, and program type.

### **TYPE OF INSTITUTION**

Usage of PSLs is more prevalent for students at for-profit schools in the 2007-2008 academic year than at non-profit schools with comparable program length, and this difference is statistically significant. At two year schools, 42% of students attending for-profit institutions have PSLs, compared to 5% at public institutions and 18% at private not-for-profit schools.<sup>104</sup> Similarly, at four year schools, 46% of students at for-profit institutions have PSLs, while 14% of students at public institutions have PSLs and 25% of students at private not-for-profit schools have PSLs.<sup>105</sup> Also, 34% of students enrolled in less-than-two-year for-profit institutions have PSLs, while 16% of students enrolled at private not-for-profit less-than-two-year institutions have PSLs.<sup>106</sup> Note that the majority of students who have PSLs at for-profits also have federal loans: 97% of students at two-year for-profit institutions and 96% of students at four-year for profits who have PSLs also have federal loans.<sup>107</sup> As discussed above, for-profit PSL lenders severely curtailed lending to students at for-profit schools after 2007-2008, when the last NPSAS study was conducted, which may affect usage reported in NPSAS:12

## **ATTENDANCE INTENSITY**

Borrowing patterns also vary by attendance intensity. Students who are exclusively part time use PSLs at a lower rate than students who are exclusively full time: 19% versus 7%.<sup>108</sup> Among student loan borrowers, the proportion with a PSL is approximately 37% for both groups.<sup>109</sup> Some of the differences in the frequency of borrowing between the two groups could be affected by eligibility criteria for federal loan programs and underwriting and pricing practices for PSLs.

### **PROGRAM TYPE**

Students' use of PSLs differs by program type. Students in associate's degree programs are less likely than bachelor's degree candidates to have PSLs: 9% and 19%, respectively.<sup>110</sup> Note that this includes both full-time and part-time students, and attendance intensity may vary by program length. Also, 21% of students in certificate programs use PSLs.<sup>111</sup>

**TABLE 4: UNDERGRADUATE STUDENT PARTICIPATION IN LOAN PRODUCT TYPES , BY DEMOGRAPHIC CHARACTERISTICS (2007-2008 AND 2003-2004 ACADEMIC YEARS)**

		Academic Year 2007-2008				Academic Year 2003-2004			
		Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)	Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)
All Students		3.6 (0.09)	24.5 (0.19)	10.6 (0.16)	61.3 (0.24)	1.1 (0.18)	29.1 (0.04)	3.9 (0.17)	65.9 (0.14)
Gender	Male	3.7 (0.17)	21.8 (0.33)	9.5 (0.20)	65.0 (0.45)	1.2 (0.08)	27.3 (0.38)	4.1 (0.25)	67.4 (0.50)
	Female	3.5 (0.10)	26.6 (0.27)	11.4 (0.25)	58.5 (0.26)	1.0 (0.05)	30.4 (0.26)	3.7 (0.12)	64.8 (0.25)
Age (As of 12/31)									
18 or Younger		2.3 (0.20)	27.8 (0.66)	9.2 (0.42)	60.7 (0.8)	0.8 (0.10)	30.7 (0.77)	5.3 (0.30)	63.2 (0.93)
19-23		4.1 (0.11)	25.1 (0.28)	11.4 (0.20)	59.4 (0.32)	1.4 (0.07)	31.7 (0.36)	5.1 (0.17)	61.9 (0.41)
24-29		4.1 (0.29)	25.8 (0.52)	11.7 (0.43)	58.4 (0.61)	1.0 (0.10)	32.8 (0.71)	3.0 (0.22)	63.2 (0.70)
30-39		2.8 (0.22)	24.7 (0.60)	10.1 (0.47)	62.4 (0.78)	0.7 (0.10)	25.3 (0.62)	2.3 (0.24)	71.7 (0.58)
40 or Older		2.4 (0.18)	16.4 (0.68)	7.0 (0.47)	74.2 (0.83)	0.7 (0.09)	16.6 (0.65)	1.0 (0.16)	81.7 (0.65)
Race									
White		3.7 (0.10)	24.2 (0.42)	10.7 (0.24)	61.5 (0.54)	1.1 (0.05)	28.9 (0.51)	4.2 (0.17)	65.8 (0.60)
Black or African American		3.3 (0.23)	32.4 (0.74)	14.0 (0.56)	50.4 (1.05)	0.9 (0.10)	37.8 (1.57)	3.2 (0.25)	58.1 (1.65)
Hispanic or Latino		3.7 (0.22)	21.2 (0.83)	9.5 (0.43)	65.6 (1.09)	1.1 (0.13)	24.9 (0.84)	3.5 (0.37)	70.5 (0.91)
Asian		3.0 (0.38)	17.3 (0.80)	5.3 (0.34)	74.4 (0.89)	1.3 (0.20)	20.0 (0.92)	2.8 (0.29)	75.9 (0.98)
Other		3.1 (0.40)	25.6 (1.13)	9.6 (0.61)	61.7 (1.21)	1.2 (0.22)	27.5 (1.09)	4.0 (0.38)	67.3 (1.12)

Source: NPSAS 2008 and NPSAS 2004.

The names of the variables used in this table are: PRIVPACK, GENDER, RACE and AGE.

The weight variable used in this table is WTA000.

Standard errors in parentheses.

**TABLE 5:** UNDERGRADUATE STUDENT PARTICIPATION IN LOAN PRODUCT TYPES , BY FAMILY CHARACTERISTICS (2007-2008 AND 2003-2004 ACADEMIC YEARS)

		2007-2008 Academic Year				2003-2004 Academic Year			
		Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)	Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)
All Students		3.6 (0.09)	24.5 (0.19)	10.6 (0.16)	61.3 (0.24)	1.1 (0.18)	29.1 (0.04)	3.9 (0.17)	65.9 (0.14)
Dependency Status	Dependent	3.8 (0.11)	25.5 (0.27)	11.2 (0.19)	59.4 (0.33)	1.3 (0.07)	31.9 (0.41)	5.5 (0.17)	61.4 (0.49)
	Independent	3.3 (0.14)	23.4 (0.30)	9.9 (0.27)	63.4 (0.35)	0.9 (0.05)	26.2 (0.37)	2.3 (0.15)	70.6 (0.33)
Parental Education									
	High School or Less	3.4 (0.13)	25.4 (0.30)	11.4 (0.28)	59.8 (0.37)	0.9 (0.07)	30.6 (0.43)	3.5 (0.20)	64.9 (0.41)
	College, no Degree	3.8 (0.27)	25.8 (0.61)	10.8 (0.39)	59.6 (0.78)	1.1 (0.14)	30.0 (0.54)	4.3 (0.27)	64.6 (0.59)
	Associate's Degree/ Vocational Training	3.7 (0.27)	25.5 (0.51)	11.8 (0.38)	59.1 (0.69)	1.2 (0.13)	28.4 (0.68)	4.4 (0.29)	66.1 (0.74)
	Bachelor's Degree	3.7 (0.14)	23.8 (0.41)	10.2 (0.29)	62.4 (0.47)	1.1 (0.10)	27.9 (0.44)	4.2 (0.22)	66.8 (0.50)
	Post- Graduate Degree	3.5 (0.2)	22.0 (0.39)	8.5 (0.24)	66.0 (0.47)	1.2 (0.11)	27.0 (0.53)	3.9 (0.25)	67.9 (0.67)
Census Region of Permanent Residence									
	Northeast	4.3 (0.21)	27.8 (0.90)	15.9 (0.66)	52.1 (1.39)	1.4 (0.14)	35.6 (2.36)	6.5 (0.57)	56.4 (2.74)
	Midwest	3.6 (0.17)	29.9 (0.51)	12.7 (0.53)	53.7 (0.75)	1.1 (0.10)	32.6 (1.42)	4.7 (0.29)	61.6 (1.6)
	South	3.5 (0.15)	25.4 (0.52)	9.9 (0.37)	61.2 (0.77)	0.9 (0.08)	30.9 (1.04)	3.3 (0.24)	64.9 (1.09)
	West	2.7 (0.16)	18.1 (0.52)	6.9 (0.34)	72.3 (0.62)	0.8 (0.09)	21.9 (1.03)	2.7 (0.25)	74.5 (1.07)
	Other	7.0 (0.84)	7.8 (0.96)	3.6 (0.62)	81.6 (1.53)	2.8 (0.50)	8.7 (2.40)	0.7 (0.28)	87.8 (2.47)

Income Quartile	First Quartile	3.4 (0.2)	29.8 (0.52)	10.5 (0.3)	56.3 (0.58)	0.9 (0.08)	33.4 (0.48)	3.7 (0.23)	62.0 (0.47)
	Second Quartile	3.8 (0.17)	27.4 (0.37)	12.1 (0.39)	56.7 (0.54)	1.1 (0.09)	35.0 (0.57)	4.3 (0.21)	59.6 (0.55)
	Third Quartile	3.9 (0.17)	24.2 (0.39)	11.5 (0.34)	60.4 (0.56)	1.2 (0.09)	29.0 (0.52)	4.4 (0.24)	65.4 (0.65)
	Fourth Quartile	3.1 (0.14)	16.5 (0.54)	8.2 (0.25)	72.1 (0.57)	1.1 (0.09)	18.4 (0.55)	3.1 (0.16)	77.4 (0.63)

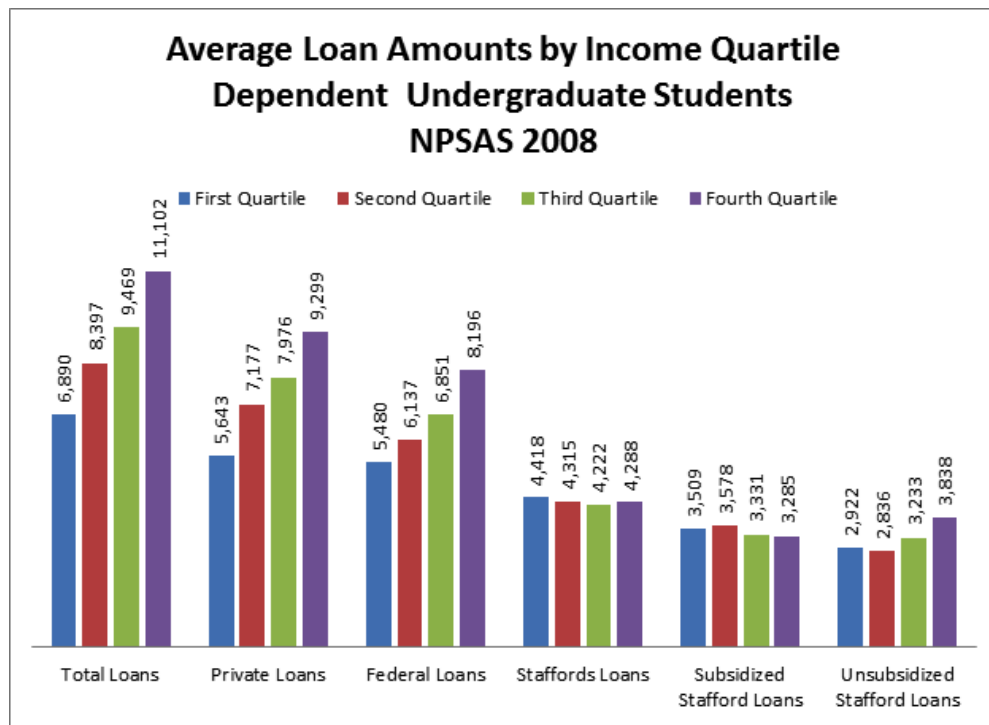
Source: NPSAS 2008 and NPSAS 2004.

Standard errors in parentheses.

The names of the variables used in this table are: PRIVPACK, PAREduc, PCTALL, DEPEND and STUSTATE.

The weight variable used in this table is WTA000.

**FIGURE 15: AVERAGE 2007-2008 ACADEMIC YEAR LOAN AMOUNTS BY INCOME QUARTILE, INDIVIDUALS WHO REPORT POSITIVE LOAN AMOUNTS**



Source: NPSAS 2008

The names of the variables used in this chart are: STAFSUB, STAFFAMT, PRIVLOAN, TFEDLN2, PCTDEP, TOTLOAN2 and STAFUNSB.

Note that federal loans includes PLUS loans.

**TABLE 6:** UNDERGRADUATE STUDENT PARTICIPATION IN LOAN PRODUCT TYPES, BY INSTITUTION AND PROGRAM CHARACTERISTICS (2007-2008 AND 2003-2004 ACADEMIC YEARS)

	2007-2008 Academic Year				2003-2004 Academic Year			
	Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)	Private Loans Only (%)	Non- Private Loans Only (%)	Both Non- Private and Private Loans (%)	No Loans (%)
All Students	3.6 (0.09)	24.5 (0.19)	10.6 (0.16)	61.3 (0.24)	1.1 3.57	29.1 0.27	3.9 4.13	65.9 0.57
Institution Sector								
Public Less-Than- 2-Year	3.2 (0.95)	11.0 (0.88)	3.9 (0.92)	81.9 (1.03)	1.1 (0.47)	7.5 (1.93)	0.7 (0.32)	90.6 (2.27)
Public 2-Year	2.9 (0.16)	9.6 (0.15)	1.9 (0.09)	85.6 (0.28)	0.8 (0.07)	9.1 (0.12)	0.7 (0.05)	89.4 (0.15)
Public 4-Year	4.3 (0.14)	33.0 (0.26)	9.6 (0.21)	53.0 (0.26)	1.3 (0.09)	40.8 (0.29)	3.8 (0.17)	54.1 (0.30)
Private Not-for- Profit, Less-Than- 2-Year	5.4 (1.14)	20.4 (12.7)	10.5 (5.96)	63.7 (19.2)				
Private Not-for- Profit, 2-Year	2.7 (0.77)	32.1 (7.07)	15.0 (3.50)	50.3 (9.33)				
Private Not-for- Profit Less than 4- Year					1.3 (0.44)	33.7 (3.30)	4.2 (1.05)	60.9 (3.48)
Private Not-for- Profit 4-Year	3.9 (0.28)	34.9 (0.50)	20.6 (0.47)	40.6 (0.53)	1.5 (0.13)	45.3 (0.56)	9.8 (0.55)	43.4 (0.63)
Private for-profit Less-than-2-Year	10.1 (0.73)	43.5 (1.09)	24.2 (1.18)	22.2 (0.88)	1.4 (0.13)	61.6 (1.88)	7.8 (0.36)	29.2 (1.98)
Private for-Profit 2 Years or More					1.0 (0.19)	66.4 (1.99)	13.1 (1.82)	19.5 (0.98)
Private for-Profit 2- Year	1.2 (0.32)	54.9 (3.19)	40.6 (2.91)	3.3 (0.62)				
Private for-Profit 4- Year	1.7 (0.22)	49.0 (2.02)	44.7 (1.96)	4.6 (0.44)				

Attendance Intensity								
Exclusively Full-Time	3.8 (0.13)	32.9 (0.34)	15.2 (0.26)	48.0 (0.34)	1.2 (0.07)	39.6 (0.39)	6.0 (0.25)	53.1 (0.45)
Exclusively Part-Time	3.2 (0.14)	11.6 (0.50)	3.7 (0.28)	81.4 (0.73)	0.7 (0.07)	13.4 (0.36)	0.9 (0.07)	85.0 (0.37)
Mixed Full-Time and Part-Time	3.5 (0.16)	27.8 (0.48)	12.0 (0.36)	56.7 (0.52)	1.3 (0.12)	31.4 (0.74)	4.0 (0.22)	63.2 (0.76)
Program Type								
Certificate	5.3 (0.45)	24.8 (1.29)	15.5 (1.04)	54.3 (1.63)	1.1 (0.18)	34.3 (1.55)	3.9 (0.25)	60.6 (1.59)
Associate's Degree	2.9 (0.17)	15.3 (0.34)	6.1 (0.20)	75.6 (0.39)	0.8 (0.08)	15.8 (0.55)	2.1 (0.24)	81.3 (0.55)
Bachelor's Degree	4.0 (0.11)	34.8 (0.28)	14.8 (0.23)	46.4 (0.29)	1.3 (0.07)	43.4 (0.36)	6.0 (0.19)	49.2 (0.39)
Not in a Degree Program	2.6 (0.29)	6.2 (0.62)	2.0 (0.44)	89.2 (0.95)	0.8 (0.16)	7.7 (0.52)	0.9 (0.16)	90.7 (0.61)

Source: NPSAS 2008 and NPSAS 2004.

The names of the variables used in this table are: PRIVPACK, UGDEG, SECTOR1 and ATTNPTRN.

The weight variable used in this table is WTA000.

Standard errors in parentheses.



**TABLE 7:** AVERAGE LOAN AMOUNTS BY SCHOOL TYPE,  
UNDERGRADUATES WITH POSITIVE LOAN AMOUNTS, 2007-2008 ACADEMIC  
YEAR

Institution Sector	Private Loans Only	Private and Non-Private Loans			Non-Private Loans Only
	Total Loans (\$)	Total Loans (\$)	Private Loans (\$)	Federal Loans (\$)	Total Loans (\$)
Public 4-Year	7,563 (186.0)	11,441 (118.8)	5,674 (92.7)	5,595 (71.0)	6,706 (75.4)
Private Not-for-Profit 4-Year	11,737 (697.0)	\$15,553 (231.4)	8,771 (177.2)	6,641 (120.9)	8,160 (181.6)
Private for-Profit 4- Year	7,878 (927.0)	\$12,282 (322.3)	6,249 (269.3)	5,923 (166.6)	6,477 (345.7)
Public 2-Year	\$3,662 (130.2)	\$7,732 (224.3)	3,884 (118.3)	3,831 (139.7)	4,093 (162.8)
Private Not-for-Profit 2-Year	\$6,288 (736.1)	\$12,094 (1002.2)	6,613 (693.7)	5,069 (268.4)	6,314 (342.4)
Private for-Profit 2- Year	\$6,784 (573.7)	\$11,734 (636.5)	6,016 (446.0)	5,708 (240.2)	6,210 (309.3)
Private Not-for-Profit, Less-Than-2-year	‡ ‡	\$11,683 (1664.1)	6,717 (1024.7)	4,966 (755.4)	5,712 (1112.4)
Public Less-than-2-Year	4,594 (660.9)	\$9,134 (580.0)	4,050 (320.6)	5,059 (417.9)	4,915 (296.5)
Private for-Profit Less- Than-2-Year	5,287 (299.0)	10,148 (239.0)	4,687 (198.4)	5,446 (156.5)	5,789 (209.1)

Source: NPSAS:08. Undergraduates.

‡ Unstable estimate, output suppressed.

Standard errors in parentheses.

Sample restricted to undergraduates with positive loan amounts for either private or non-private loans.

The names of the variables used in this table are: PRIVPACK, PRIVLOAN, TFEDLN2, TOTLOAN2 and SECTOR1.

The weight variable used in this table is WTA000.

## LOAN AMOUNTS

Table 7 reports mean loan amounts by institution type for borrowers who only have PSLs, borrowers with a combination of PSL and non-PSL loans (federal, state, and institutional loans), and borrowers with federal loans only. Unsurprisingly, for students who have any educational loans, total loan amounts are largest for those who have a combination of PSL and non-PSL loans, across all institutional sectors. For example, among students who attend public 4-year institutions, the amount borrowed is \$7,563 for students who only have PSLs, \$6,706 for students with only non-private loans, and \$11,441 for students with a combination of PSL and non-PSL. Also, the mean total loan amount for borrowers with a combination of PSL and non-PSL is significantly larger for students who attend private 4-year non-profit schools (\$15,553) than it is for students who attend 4-year public schools (\$11,441).<sup>112</sup>

For students who attend two-year schools, total loan amounts are larger for those who attend private (either not-for-profit or for-profit) schools than for those who attend public schools. This holds across all borrower categories: individuals with private loans only (differences of \$2,627<sup>113</sup> and \$3,122<sup>114</sup> respectively), individuals with a combination of private and non-private loans (differences of \$1,027<sup>115</sup> and \$675<sup>116</sup>, respectively), and individuals with non-private loans only (differences of \$2,222<sup>117</sup> and \$2,117<sup>118</sup> respectively).

## USE OF OTHER FORMS OF FINANCIAL AID

As discussed earlier, educational borrowing is only one source of funding for school, and it is important to understand it in the context of other sources of student funding. PSL borrowers make use of other forms of student aid, such as federal and private grants, work study, and academic, athletic or need-based scholarships.<sup>119</sup>

### GRANTS AND WORK STUDY

Table 8 presents the percentage of students who have grant or work study awards by the type of educational loans that they have, and average amounts of these forms of aid for those who report a positive amount. Although a higher proportion of students with non-private loans have grants compared to students who have a combination of private and non-private loans,<sup>120</sup> there is no statistical difference between the mean grant amounts for these groups.<sup>121</sup> Also, the proportion of students with a combination of PSLs and federal loans who participate in work study is not statistically different from the proportion of students with federal loans only who participate in work study.<sup>122</sup>

### STAFFORD LOAN EXHAUSTION

As shown in Table 9, most PSL borrowers apply for student aid; only 12.2% do not. Also, 10.9% of PSL borrowers apply for aid but do not take up Stafford loans. Put another way, of undergraduates who apply for federal aid and take up PSLs, 12.4% do not have Stafford loans.<sup>123</sup> Many PSL borrowers who also have Stafford loans do not

exhaust their loan limits: approximately 40% of PSL borrowers with Stafford loans do not borrow their individual Stafford loan maximum.<sup>124</sup> As discussed above, with few exceptions, this is rarely an economically beneficial choice.

**TABLE 8: NON-LOAN FINANCIAL AID BY LOAN TYPE, 2007-2008 ACADEMIC YEAR**

<u>Loan Type</u>	Grants		Work Study	
	Percentage (%)	Average Amount if Positive (\$)	Percentage (%)	Average Amount if Positive (\$)
Private Loans Only	35.4 (1.64)	4,241 (169.8)	4.3 (0.45)	2,381 (167.3)
Non-Private Loans Only	74.0 (0.68)	5,799 (64.4)	13.0 (0.30)	2,233 (34.7)
Both Non-Private and Private Loans	68.7 (0.78)	5,847 (138.2)	14.1 (0.58)	2,053 (45.6)
No Loans Received	40.8 (1.59)	3,931 (85.0)	4.2 (0.25)	2,818 (62.1)

Source: NPSAS:08.

Standard errors in parentheses.

The names of the variables used in this table are: PRIVPACK, TOTGRT and TOTWKST.

The weight variable used in this table is WTA000.

**TABLE 9:** AMONG STUDENTS WHO BORROWED PSLs, THE AMOUNT OF PRIVATE LOANS AND STAFFORD SUBSIDIZED/UNSUBSIDIZED LOANS BORROWED BY STAFFORD LOAN USE STATUS

	Percent (%)	Average Private Loan Amount (\$)	Average Stafford Loan Amount (\$)
Total	100.0	6,533 (88)	15,081 (31)
Did not Apply for Aid	12.2 (0.53)	7,582 (210)	†
Applied for Federal Aid but Did Not Receive a Stafford Loan	10.9 (0.66)	6,591 (356)	†
Received Stafford Loan			
Received Less than the Maximum Amount	31.4 (0.61)	6,065 (151)	3,918 (53)
Received the Maximum Amount	45.5 (0.63)	6,920 (127)	5,857 (42)

Source: NPSAS:08.

Standard errors are in parentheses.

† Not applicable.

The names of the variables used in this table are: STAFCT3, STAFFAMT, PRIVPACK, and PRIVLOAN.

The weight variable used in this table is WTA000.

## REPAYMENT BEHAVIOR AND EMPLOYMENT

The analysis of repayment behavior and employment makes use of the BPS:04/09 (Beginning Postsecondary Students study), and examines the 2009 repayment behavior of the cohort of students who began their post-secondary education in the 2003-2004 academic year. This timing means that the analysis considers individuals who, at the time of the 2009 survey, were recently out of school: for example, a member of this cohort who completed a bachelor's degree in 4 years would have graduated in 2007, and would be only two years into his or her career at the time of the 2009 wave of the

survey. Since all borrowers are responsible for repaying their federal and non-federal educational loans regardless of whether they graduate, this analysis also includes borrowers who left school without a degree as well as those who were still enrolled when the 2009 survey was conducted.

## **MONTHLY STUDENT LOAN PAYMENTS**

In this discussion of loan repayment, it is important to note that borrowers report their current payment in BPS:04/09, and this does not account for adjustments to original payment obligations such as income-based repayment, PSL deferral, or loan consolidation. Although repayment amount includes both PSL and non-PSL loan amounts, the analysis is restricted to individuals who report having a private student loan.

## **STUDENT LOAN PAYMENTS AS A FRACTION OF MONTHLY INCOME**

Table 10 shows total student loan payments as a percentage of 2009 monthly income by cumulative educational attainment, and includes students who were still actively enrolled in school at the time of the survey. The majority of students who have PSLs (63%) have monthly student loan payments that are 5% or less of their income, and 80% have monthly loan payments that are 10% or less of their income, as shown in the first two columns of Table 10. On the other end of the spectrum, 5% of PSL borrowers have monthly student loan payments that are greater than 25% of their monthly income, as shown in the last column. Among those with PSLs, 62% of bachelor's degree recipients have monthly payments that are 10% or less of their income and 10% have monthly payments greater than 25% of their monthly income. Note that by function of program length, bachelor's degree recipients may have completed their degrees more recently than individuals who attained other degrees or certificates. Individuals who did not attain a degree or certificate and had PSLs also report having student loan payments in 2009; 88% had monthly payments of 10% or less of their income.

**TABLE 10: MONTHLY STUDENT LOAN PAYMENTS IN 2009 AS A PERCENTAGE OF INCOME, PRIVATE STUDENT LOAN BORROWERS WHO BEGAN POSTSECONDARY EDUCATION IN 2003-2004**

	Monthly Student Loan Payment as a Percentage of Income					
	0 % to 5%	6% to 10%	11 to 15%	16% to 20%	21% to 25%	More than 25%
Total <sup>a</sup>	63.5 (1.86)	16.0 (1.37)	8.1 (0.89)	4.9 (0.62)	2.4 (0.49)	5.0 (0.78)
Attained Bachelor's Degree	43.3 (2.11)	18.8 (1.57)	14.8 (1.57)	8.7 (1.07)	4.3 (0.87)	10.0 (1.93)
Attained Associate's Degree	72.3 (5.18)	14.5 (3.63)	4.6 (1.90)	3.5 (1.68)	0.6 (0.58)	4.4 (1.79)
Attained Certificate	80.1 (3.06)	12.1 (2.4)	2.7 (1.07)	3.5 (1.45)	0.4 (0.38)	1.3 (1.00)
No Degree, Left Without Return	72.7 (3.16)	15.4 (2.66)	5.1 (1.63)	2.6 (0.93)	2.0 (0.77)	2.2 (0.84)

Source: BPS:04/09, restricted to individuals who had a private student loan.

Standard errors in parentheses.

<sup>a</sup>Total includes respondents who are still enrolled, which are not included in a separate row in the table.

Student loan payments include both private and federal loans.

The names of the variables used in this table are: PROUT6, EDPCT09 and LNTY09B.

The weight variable used in this table is WTB000.

## NOMINAL MONTHLY STUDENT LOAN PAYMENTS

Since income may vary between borrowers and is only reported for individuals who were employed, monthly student loan payments are also presented in nominal dollars. Table 11 considers nominal monthly student loan payments by the sector and level of institution at which a PSL borrower began his or her postsecondary education in the 2003-2004 academic year, and includes individuals who did not complete their degrees. There is a larger percentage of individuals with monthly payments of at least \$225 among PSL borrowers who started their undergraduate careers at public and not-for-profit 4-year institutions than among those who did not.<sup>125</sup> There is no statistically significant difference amongst individuals with payments of at least \$225 between the group that attended 4-year not-for-profit private schools and 4-year public schools.<sup>126</sup> Borrowers with monthly payments of \$225 or more per month also vary by educational attainment: 57% of individuals who attained a bachelor's degree have monthly payment in excess of \$225, while 34% of individuals who ever had a PSL (including those with bachelor's degree) have student loan payments in excess of \$225

per month (results not shown in table).<sup>127</sup> Recall that this includes repayment amounts for both federal and private debt, and that federal borrowing limits increase with the number of years of school attended up to a lifetime cap, so students at four-year schools may have been eligible for more federal debt than students at 2-year or less institutions.

**TABLE 11: MONTHLY STUDENT LOAN PAYMENTS IN 2009 BY FIRST TYPE OF POSTSECONDARY INSTITUTIONS, UNDERGRADUATES MATRICULATING IN 2003-2004 (INCLUDES NON-COMPLETERS)**

	Monthly student loan repayments 2009			
	\$1-69	\$70-119	\$120-224	\$225 or more
Total	20.5 (1.60)	20.4 (1.47)	25.3 (1.76)	33.7 (1.40)
Public 4-Year	14.9 (2.31)	13.7 (1.99)	26.2 (2.65)	45.2 (2.73)
Private Not-for-Profit 4-Year	10.5 (1.90)	13.0 (1.83)	25.5 (2.92)	51.1 (2.74)
Private For-Profit 4-Year	20.5 (8.71)	15.4 (6.67)	43.7 (11.60)	20.4 (8.54)
Public 2-Year	20.7 (2.99)	24.5 (3.59)	22.9 (3.00)	31.8 (3.60)
Private Not-for-Profit 2-Year	18.5 (12.4)	31.6 (15.3)	38.8 (16.5)	11.0 (10.4)
Private for-Profit 2-Year	35 (10.1)	28.7 (6.77)	22.8 (6.72)	13.5 (4.18)
Private for-Profit, Less Than 2-Year	39.6 (2.87)	36.5 (3.13)	14.4 (1.68)	9.6 (2.47)

Source: BPS:04/09, restricted to private student loan borrowers.

Standard errors in parentheses.

The names of the variables used in this table are: LNTY09B, PROUT6, RPYAMT09, FSECTOR and LNTY09B.

The weight variable used in this table is WTB000.

## FEDERAL LOAN REPAYMENT OF PSL BORROWERS WHO BEGAN POST-SECONDARY EDUCATION AT 2-YEAR OR LESS INSTITUTIONS

NCES longitudinal studies do not provide data on PSL repayment, but we do have information on federal loan repayment for PSL borrowers. Since bachelor's degree graduates in this cohort who graduated on-time would have graduated in 2007, sufficient time probably had not elapsed as of the 2009 survey for that survey to be able to accurately report the default rate on federal loans for this group. Therefore, Table 12 presents repayment status on federal loans for PSL borrowers by the type of institution where they started their post-secondary education, restricted to individuals who began their education at 2-year or less-than-2-year schools. This does not include all PSL borrowers, since only individuals who also have federal student loans are included. Among PSL borrowers who also had federal loans, a higher proportion of individuals who started their postsecondary education at 2 year for-profit institutions



are in default on their federal loans than those started at 2 year public institutions: 18% and 5%, respectively.<sup>128</sup>

**TABLE 12:** FEDERAL STUDENT LOAN REPAYMENT AMONG PSL BORROWERS, 2009, TWO OR LESS YEAR INSTITUTIONS

Type of Institution First Attended	Federal Student Loan Repayment Status in 2009				
	Loans Paid in Full or Cancelled (%)	In Repayment (%)	Deferred/ Forbearance (%)	In Default (%)	Not in Repayment (%)
Public 2-Year	7.2 (1.59)	44.6 (2.79)	15.7 (2.49)	4.5 (0.96)	28.0 (2.91)
Private Not-For-Profit 2-year	10.1 (8.34)	69.0 (11.70)	7.4 (6.75)	4.1 (6.05)	9.4 (7.18)
Private For-Profit, 2-year	9.6 (2.97)	60.8 (5.7)	10.5 (3.14)	18.4 (4.60)	0.8 (0.48)
Private For-Profit, Less Than 2-Year	16.6 (2.09)	42.6 (4.39)	18.2 (3.45)	18.5 (2.66)	4.0 (1.13)

Source: BPS:04/09, restricted to individuals who had both private and federal loans.

Standard errors in parentheses.

The names of the variables used in this table are: PROUT6, LOANST09, FSECTOR and LNTY09B.

The weight variable used in this table is WTB000.

## EMPLOYMENT AND EARNINGS

Table 13 presents employment rates at the time of the 2009 follow-up survey for individuals in the 2003 student cohort who ever had a PSL. Unemployment rates were calculated by dividing the percentage of individuals in a group who were not employed but were looking for employment by the percentage of people who were either employed or not employed but looking, which results in a calculated unemployment rate of 16.4% for the BPS:04/09 cohort. Note that 6% of the sample is not employed and not looking for employment, and the proportion of individuals out of the labor force varies by educational attainment: the proportion of individuals who left postsecondary education without a degree who are out of the labor force is higher than the proportion of bachelor's degree<sup>129</sup> or associate's degree<sup>130</sup> recipients who are out of the labor force. Also, the proportion of PSL borrowers employed is significantly higher for those who attained bachelor's<sup>131</sup> and associate's degrees<sup>132</sup> than for those whose highest level of attainment was a certificate or no degree, but there is no statistical difference between the proportion of individuals with bachelor's degrees or associate's degrees who are employed.<sup>133</sup> Table 14 presents mean incomes for individuals who report positive income in the 2009 survey by attainment and by institution type first attended. It includes income data both for individuals who used PSLs and for individuals who did not use PSLs. Mean incomes do not differ significantly between PSL borrowers and non-PSL borrowers for any of these categories.

**TABLE 13:** EMPLOYMENT FOR PSL BORROWERS IN 2009 , INDIVIDUALS WHO ENTERED POSTSECONDARY EDUCATION IN 2003-2004

	Employed (%)	Not Employed, Looking for Employment (%)	Not Employed and Not Currently Looking for Employment (%)	Calculated Unemployment Rate <sup>b</sup>
Total <sup>a</sup>	78.73 (1.32)	15.48 (1.19)	5.79 (0.91)	16.4%
Cumulative Persistence and Attainment				
Attained Bachelor's Degree	88.18 (1.47)	10.31 (1.33)	1.51 (0.43)	10.5%
Attained Associate's Degree	85.74 (4.46)	12.06 (4.07)	2.20 (1.20)	12.3%
Attained Certificate	73.74 (3.64)	18.67 (3.18)	7.60 (2.04)	20.2%
No Degree, Left Without Return	73.03 (2.41)	17.89 (2.04)	9.08 (1.81)	19.7%

Source: BPS:04/09. Restricted to PSL borrowers.

Standard errors in parentheses.

<sup>a</sup> Includes individuals who are currently enrolled.

<sup>b</sup> Percent not employed but currently looking divided by sum of percent employed and percent not employed and currently looking.

The names of the variables used in this table are: LNTY09A, PROUT6, and JOBSTB09.

The weight variable used in this table is WTB000.

**TABLE 14:** 2009 INCOME BY PSL STATUS, INDIVIDUALS WHO ENTERED POSTSECONDARY EDUCATION IN 2003-2004

	Income in Dollars	
	Individuals with No Private Student Loans (\$)	Private Student Loan Borrowers (\$)
Total	31,114 (625.1)	31,855 (694.4)
Panel A: Income by Cumulative Persistence and Attainment		
Attained Bachelor's Degree	34,953 (628.3)	35,588 (1000.4)
Attained Associate's Degree	34,920 (2273.7)	33,680 (2264.6)
Attained Certificate	29,508 (3563.4)	27,248 (1227.8)
No Degree, Still Enrolled	25,525 (1691.8)	‡ ‡
No Degree, Left Without Return	27,462 (728.6)	29,876 (1064.1)
Panel B: Income by Institution Type First Attended		
Public 4-Year	33,549 (632.6)	32,393 (1070)
Private Not-for-Profit 4-Year	32,237 (793.6)	34,740 (1519.1)
Private for-Profit 4-Year	25,146 (3365.3)	33,554 (3817.4)
Public 2-Year	31,008 (1643.8)	31,834 (1329.2)
Private Not-for-Profit 2-Year	31,765 (4303.6)	40,466 (8041.9)
Private for-Profit 2-Year	27,093 (2532.1)	27,690 (2181.2)
Public Less-than-2-Year	29,244 (3261.1)	‡ ‡
Private Not-for-Profit, Less Than -2-Year	‡ ‡	‡ ‡
Private For-Profit, Less Than -2-Year	24,768 (860.4)	25,582 (1637.3)

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Standard errors in parentheses.

Source: BPS:04/09, restricted to individuals who report non-zero income.

‡ Unstable estimate, output suppressed.

The names of the variables used in this table are: PROUT6, INCRE509, FSECTOR and LNTY09B.

The weight variable used in this table is WTB000.

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## **SAMPLE LENDER PORTFOLIO DATA SHOWS THAT MANY RECENT GRADUATES HAVE DIFFICULTY MAKING PSL PAYMENTS.**

The NCES data described above shows the broad context of PSL borrowers who graduated in 2007 and 2008, at the beginning of the recent recession. In broad strokes, most had manageable debt loads from both federal loans and PSLs, both in terms of nominal dollar amount and in terms of percentage of income. At the margin, however, are graduates like those with recent bachelor's degrees, ten percent of whom have debt service payments in excess of 25% of their income. Because federal loans can be reduced to well below that level under income-based repayment, these borrowers in the NCES data may illustrate the hardship of the PSL repayment difficulties described below.

As set forth in Figure 16, the cohorts of PSL borrowers who took out PSLs in 2005 through 2009 have experienced significant cumulative default rates.

**FIGURE 16:** (BASED ON \$'S) GROSS CUMULATIVE DEFAULT CURVES  
BY ORIGINATION VINTAGE (2005-2009) BY YEARS OF SEASONING  
(SAMPLE LENDER PORTFOLIO)

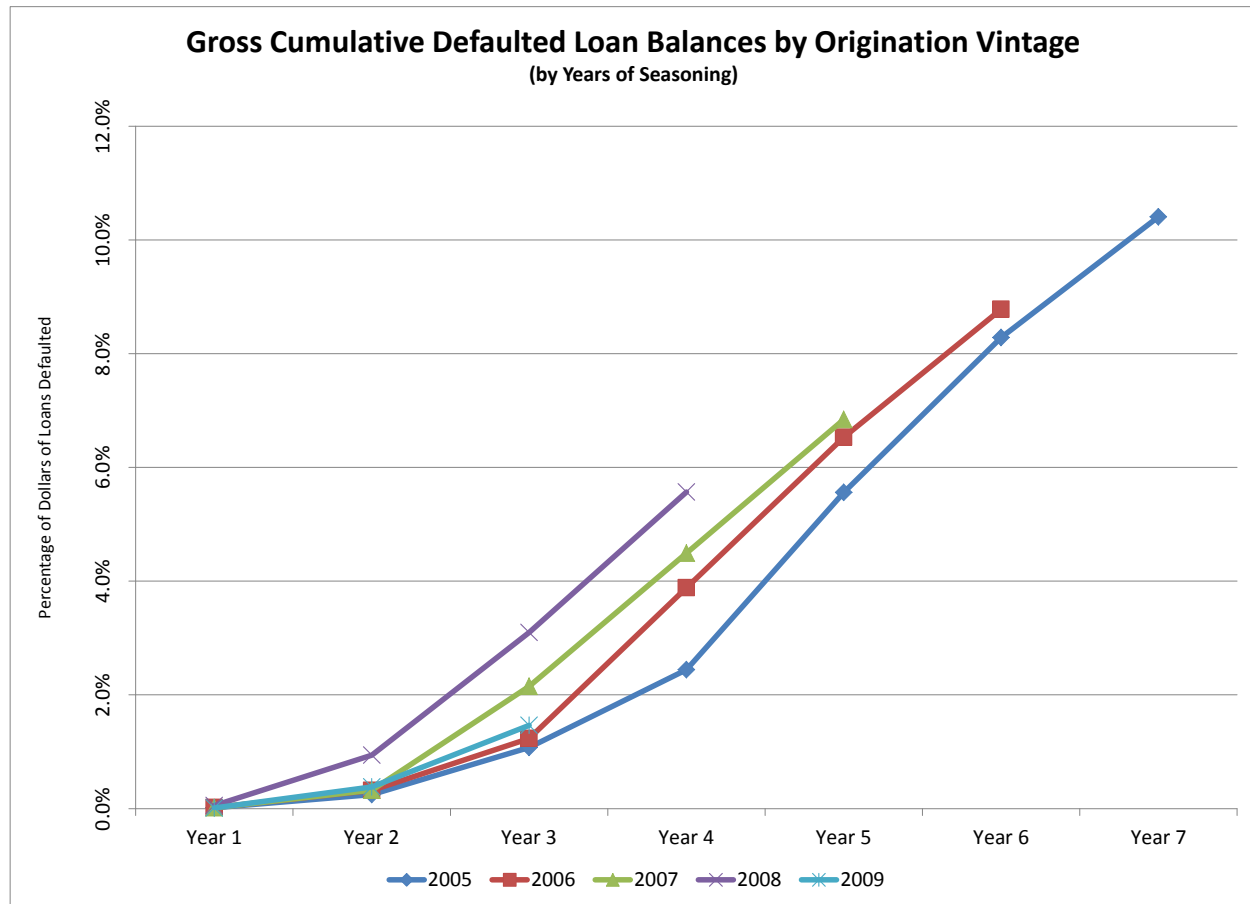
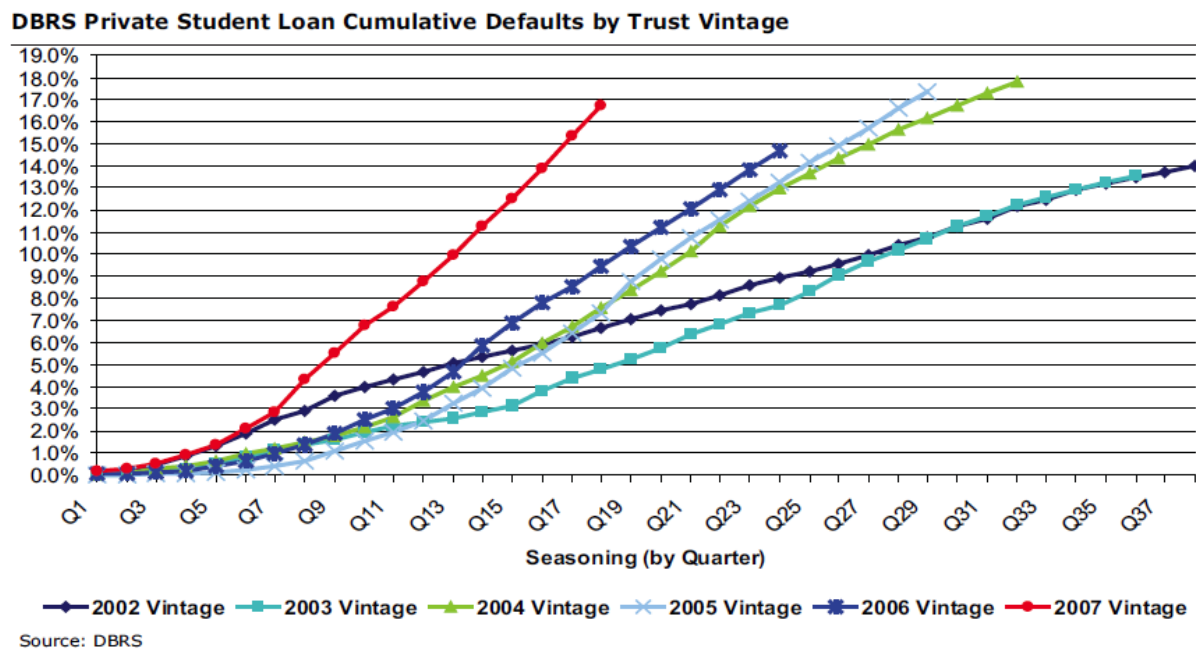


Figure 16, above, shows data from the Sample Lender Portfolio data set. More than 10% of borrowers who took out a PSL in 2005 (and separated in 2006 through 2009) had defaulted by 2011 (6 years after origination). Similar difficulties with repayment can be found with loans that are now owned in SLABS trusts. Moody's and DBRS track PSL default rates by vintage of the trust formation. That dating is roughly equivalent to the year a loan was made. Thus, the following figure approximates default rates for borrowers who took out loans in the 2005 - 2007 period.

**FIGURE 17: DBRS ABS LIFETIME GROSS CUMULATIVE LOSSES**



Default rates spiked significantly following the financial crisis of 2008 as the subsequent recession exposed the weakened underwriting standards that were fueled by the capital markets during the securitization and lending boom.<sup>134</sup> Default rates have since stabilized significantly, but are expected to remain high.<sup>135</sup> Please note that the cumulative default experience in the DBRS data exceeds the default experience shown in the data from the lenders in our sample lender data. As our sample lenders are largely composed of banks and depositories, it is likely that a mix of retained credit risk, tighter prudential regulation, and survivor bias contribute to the differing loan loss experience between our sample and the larger market, particularly with regard to the 2005 – 2007 period.

It is not clear that all of the dust from the PSL origination boom has settled. Of the \$140 billion Sample Lender Portfolio, only \$97 billion is in repayment and current. Over \$30 billion is deferred or in forbearance.<sup>136</sup> More recent graduates may be unable to keep up with PSL payments. Table 15, below, shows the status of the Sample Lender Portfolio at the end of 2011. Please note that the percentage of loans in deferral has substantially declined since 2008 as a result of the concurrent decline in originations. When fewer new (deferred) loans are originated, the percentage of the total loan population in deferral will necessarily decrease over time.

**TABLE 15: \$'S OF LOANS OUTSTANDING AS OF EACH CALENDAR YEAR END SHOWN BY CATEGORY (INCLUDING DEFERRED LOANS) (SAMPLE LENDER PORTFOLIO)**

<b>Loans Outstanding by Status as of Calendar Year End (Includes Deferred Loans)</b>										
Dollars in Millions										
	Total Outstanding	Current	30 dpd	60 dpd	90 dpd	120 dpd	Forbearance	Deferment	Bankruptcy	
2005	\$ 55,893.5	\$ 24,359.0	\$ 785.7	\$ 314.9	\$ 196.6	\$ 241.9	\$ 4,215.8	\$ 25,538.4	\$ 241.2	
2006	77,089.0	33,922.1	1,261.4	541.6	384.0	542.1	5,922.3	34,360.6	154.9	
2007	101,071.6	44,327.5	1,432.5	726.8	501.2	765.3	10,001.8	43,063.0	253.4	
2008	123,811.0	60,529.1	2,459.7	1,180.7	858.3	1,445.9	5,333.8	51,651.1	352.5	
2009	132,961.3	72,399.0	2,920.9	1,586.4	1,394.4	2,978.0	3,833.5	46,999.0	850.1	
2010	136,656.3	85,432.7	3,132.1	1,585.9	1,357.6	3,058.8	3,126.2	37,731.0	1,231.8	
2011	140,244.3	97,426.9	3,378.3	1,732.7	1,441.9	2,884.7	3,376.0	28,524.0	1,479.8	

<b>Percentage of Loans by Status as of Calendar Year End (Including Deferred Loans)</b>									
	Current	30 dpd	60 dpd	90 dpd	120 dpd	Forbearance	Deferment	Bankruptcy	
2005	43.6%	1.4%	0.6%	0.4%	0.4%	7.5%	45.7%	0.4%	
2006	44.0%	1.6%	0.7%	0.5%	0.7%	7.7%	44.6%	0.2%	
2007	43.9%	1.4%	0.7%	0.5%	0.8%	9.9%	42.6%	0.3%	
2008	48.9%	2.0%	1.0%	0.7%	1.2%	4.3%	41.7%	0.3%	
2009	54.5%	2.2%	1.2%	1.0%	2.2%	2.9%	35.3%	0.6%	
2010	62.5%	2.3%	1.2%	1.0%	2.2%	2.3%	27.6%	0.9%	
2011	69.5%	2.4%	1.2%	1.0%	2.1%	2.4%	20.3%	1.1%	

Note: percentages may not equal 100% due to rounding

Source: Sample Lender loan level data

A pattern of difficulty in making payments is summarized in the default data in the Sample Lender Portfolio data, as set forth in Table 16, below:

**TABLE 16: DEFAULTED LOANS (\$'S) BY EACH CALENDAR YEAR SHOWN (ALL VINTAGES REPORTED 1999 - 2011)<sup>f</sup>**

<b>Cumulative Lifetime Defaulted Loans as of Q4 2011 by Origination Vintage (\$ MM's)</b>						
<b>Prior to 2005</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>To Date</b>
2,407.7	1,351.9	1,525.2	1,602.7	1,123.3	128.1	8,138.9

Source: Sample Lender loan level data

The cumulative defaults are over \$8.1 billion, representing approximately 850,000 distinct loans at an average amount of \$9,700 in the Sample Lender Portfolio. The consolidated, de-identified dataset does not permit us to discern how many loans involve the same borrower. However, while serial borrowing may reduce the number of affected individuals, the incidence of co-signers for these loans will increase the number of affected consumers.

The scope of repayment difficulty varies greatly across lender types. Some securitized trusts heavily loaded with direct to consumer loans have default rates expected to reach 50%.<sup>137</sup> In contrast, some depository institution lenders who never made loans for sale have annual default rates that stayed below 4% in the worst of the

<sup>f</sup> Due to the methodology of de-identifying lender data, we cannot compute defaults as a percentage of originations in any given year.



downturn. It would be incorrect to paint all lenders with the same brush when evaluating repayment risk.

To summarize, the combination of looser credit standards, over-borrowing and the recent recession caused a significant number of PSL borrowers to have difficulty with repayment. We are unable to determine precisely how many, but the number is significant.

## **BORROWERS HAVING DIFFICULTY WITH REPAYMENT HAVE FEW OPTIONS TO CHANGE THEIR BEHAVIOR.**

Financial institution lenders have reported efforts to mitigate repayment difficulties that varied over the last five years.<sup>138</sup> The student loan programs offered in the federal Direct Loan program and the former FFEL program offer deferment or forbearance of repayment, income-based and income-contingent repayment plans, public service debt forgiveness and methods to cure default, such as rehabilitation and consolidation.<sup>139</sup> In contrast, income-based or income-contingent repayment has never been a feature of private loans and is not now contemplated.

Prior to the financial crisis of 2008, many lenders allowed twelve months of payment forbearance in the case of economic or medical hardship.<sup>140</sup> With the bankruptcy of the largest guarantor of PSLs and the close scrutiny of balance sheets that came with the financial crisis,<sup>141</sup> the incidence of PSL forbearance dropped substantially: at the end of calendar year 2007, 17.1% of loans outstanding were in forbearance while at the end of calendar year 2011 3.0% of loans were in forbearance. Table 17 shows the rapid drop in percentage of loans in forbearance in the Sample Lender Portfolio:

**TABLE 17: LOANS IN FORBEARANCE AS A % OF TOTAL LOANS IN REPAYMENT (SAMPLE LENDER PORTFOLIO)**

% Of Total Loans Outstanding by Status as of CY end (EXCLUDING Deferred Loans)							
	Current	30 dpd	60 dpd	90 dpd	120 dpd	Forb	BK
2005	79.3%	2.6%	1.0%	0.6%	0.8%	13.7%	0.8%
2006	78.8%	2.9%	1.3%	0.9%	1.3%	13.7%	0.4%
2007	76.0%	2.5%	1.2%	0.9%	1.3%	17.1%	0.4%
2008	83.5%	3.4%	1.6%	1.2%	2.0%	7.4%	0.5%
2009	83.8%	3.4%	1.8%	1.6%	3.4%	4.4%	1.0%
2010	86.0%	3.2%	1.6%	1.4%	3.1%	3.1%	1.2%
2011	87.0%	3.0%	1.5%	1.3%	2.6%	3.0%	1.3%

Note: percentages may not equal 100% due to rounding

Source: Sample Lender loan level data

The FFEL-style year of forbearance that was available until 2008-2009 has been replaced by a policy of short-term forbearances that must be supported by evidence of future ability to make payments and continued willingness to pay. Short-term forbearances may not be tacked together, but must be separated by periods of timely payments.<sup>142</sup> A significant exception to this rule applies to loans securitized under the old TERI-guaranteed servicing guidelines.<sup>143</sup> The Sample Lenders are constrained by

certain of their prudential regulators from treating loans in extended forbearance as performing assets.<sup>144</sup> Sample Lenders, following prudential guidance, have all implemented a second grace period immediately after the initial six-month post-graduation grace. The second grace period is made available based on established contact with the borrower and evidence of future willingness and ability to begin full payments.<sup>145</sup>

Lenders in our sample do not currently offer loan modification programs, such as an income-based payment reduction that is based on a debt modification.<sup>146</sup> Once a loan goes into default, neither securitization administrators nor Sample Portfolio lenders have programs in place to cure the default if the borrower becomes employed. Some Sample Lenders expressed a desire to create rehabilitation programs that would satisfy accounting rules and prudential regulators.

To summarize, for the relatively high number of PSL borrowers currently having difficulty with repayment, it is hard to avoid default and equally hard to escape it, as compared to options available to federal loan borrowers.

# Part Three: Consumer Protection

This section discusses three issues in consumer protection for PSL users:

- The scope of federal consumer financial laws<sup>147</sup> applicable to PSLs.
- The need to limit direct-to-consumer lending to control excess borrowing and lending.
- Data and arguments relevant to the current legislative debate concerning consumer protections under the Bankruptcy Code for PSL borrowers.

## **PSLs ARE SUBJECT TO A VARIETY OF FEDERAL CONSUMER FINANCIAL LAWS, AND RECENT CHANGES TO THOSE LAWS HAVE SUBSTANTIALLY CHANGED CONSUMER PROTECTION.**

PSL borrowers have significant protections under the Truth-in-Lending Act (TILA),<sup>148</sup> the Equal Credit Opportunity Act (ECOA),<sup>149</sup> the Fair Credit Reporting Act (FCRA),<sup>150</sup> the Fair Debt Collection Practices Act (FDCPA),<sup>151</sup> the Federal Trade Commission Act (FTCA),<sup>152</sup> and the Consumer Financial Protection Act.<sup>153</sup>

The most significant recent change in protection of PSL borrowers occurred under TILA. Prior to February of 2010, TILA required disclosure only at one specific time for PSL borrowers, delivered prior to legal “consummation.”<sup>154</sup> Additionally, before February 2010, TILA did not apply to loans greater than \$25,000, which would have exempted some of the largest PSLs. Under the terms of many PSL contracts, “consummation” did not occur until the time of disbursement of loan funds, meaning that students learned of their loan terms shortly before arriving at school. As of 2010, regulations issued under amendments to sections 128 and 140 of TILA require

significant disclosures at three stages of the process (a) when applications begin (b) when the lender first approves the loan, and (c) at disbursement.<sup>155</sup> A PSL borrower receives a thirty-day firm offer from the lender at loan approval. This change permits borrowers to shop among prices specific to that borrower, without time pressure to accept the first offer. After selecting a particular loan, a PSL borrower also receives a disclosure at disbursement that includes a three-day right of rescission.<sup>156</sup>

The new TILA disclosures for PSLs are unique to that product. No other installment loan is subject to quite so much disclosure. The disclosures must include information as to the rates available on federal loans and whether those rates are fixed or variable. Finally, each borrower must receive, sign and return a “self-certification” form that highlights the availability of federal aid and contains a template for computing borrowing need, the latter to limit over-borrowing.<sup>157</sup>

The new TILA procedures have only been in effect for two financial aid cycles. For most undergraduates, it will take up to four cycles before there will be a complete picture of the choices they have made to finance their education and the ability to assess the impact of the new disclosures on their shopping choices. The Agencies relied on 2008 NPSAS data to determine exhaustion of Stafford loans before using PSLs, and new 2012 NPSAS data should be available in 2013. That data should help assess the effectiveness of the new disclosure in the self-certification form and the loan cost disclosures.

Existing PSL issues under the ECOA are discussed in greater detail later in this Report. The FDCPA applies primarily after loans are transferred to a third-party collector after default. The FDCPA has not been revised for many years and only recently became the subject of general rulemaking authority by a federal agency.<sup>158</sup> Consumer protection concerns relating to the collection of PSLs are part of a larger issue involving debt collection practices generally and are beyond the scope of this Report.<sup>159</sup>

FCRA and TILA have both undergone recent revisions that have changed protections for PSL borrowers. With respect to FCRA, section 1100F of Dodd-Frank required creditors to increase their disclosure of credit scores to those consumers who pay materially higher prices under a risk-based pricing system. Many PSL borrowers dealing with financial institutions fall into that category.

## **THE FINANCIAL AID PROCESS CREATES INFORMATION GAPS NOT ADDRESSED BY TILA.**

Most of the existing federal consumer financial laws that address PSLs do so, at the earliest, at the point when a borrower sets out to shop for and apply for a particular loan with a particular lender. However, by that time, students have often already made a series of decisions regarding school without critical information that is not supplied until they apply for a loan. College acceptance decisions and related financial aid awards (including FAFSA determinations) are frequently communicated in the spring.

Subsequent to that, enrollment decisions are made, deposits are submitted, and numerous other steps are taken toward a new academic year. For an entering student, a

PSL search might take place in July or August, even though the need to use a PSL is effectively locked in by June 1. Thus, existing federal consumer financial laws may not address students' need for information about PSLs at the optimal time.

Students and their families would be better served by having access to all pertinent financial information concerning the college decision prior to deciding which college to enroll at and how much debt to incur. Provisions of the HEOA require the Secretary of Education to publish a model financial aid award letter, to improve the quality of information provided to students. The Bureau assisted the Secretary by soliciting comments from students and families on a draft "financial aid shopping sheet" that sought to clarify key elements of the financial aid decision well before PSL decisions are made.

Given the timing and information gap, generally by the time of the PSL application the student already will have made a decision that carries with it necessary implications as to how much debt to incur, and only after approval of a loan does the student have information (such as interest rate and monthly payment projections) that is necessary to determine whether debt will be manageable and whether the decision to enroll at a particular college was the best financial decision. To the extent that schools decide that recent "preferred lender list" regulations are too burdensome and decline to provide PSL information with financial aid awards, this timing problem may be exacerbated.

### **SCHOOL CERTIFICATION REDUCES THE RISK OF PSL OVER-BORROWING.**

Using the Sample Lender loan level data, the Agencies tested the level of over-borrowing (borrowing in excess of the EFC) by analyzing the changing relationship between PSL amounts and the tuition and fee component of the cost of the education for each individual borrower. Figure 7 demonstrates that the growth in the ratio of PSL loan amounts to tuition and fees is correlated with the securitization and lending boom (2005 – 2008). During that period other sources of financial aid for college were largely unchanged.<sup>160</sup> Tuition and fees admittedly increased, but Figure 7 takes that increase into account, because the ratios are computed using actual tuition and fees for each year. The rapid growth in loan amounts as a multiple of core education costs suggests that a significant portion of the incremental borrowing relative to tuition and fees represents over-borrowing above and beyond financial need.

As discussed in Part One, PSLs in the 2005-2008 period reflected increasing use of DTC lending, which circumvents controls on excessive loan amounts that can be provided by the school financial aid office. Figure 6 shows the growth of DTC lending and the reduction of school channel processing in the Sample Lender Data. During the period when DTC lending grew the most, PSL loan amounts reached 175% of tuition. Students borrowed materially more, relative to the core cost of school, without any reduction in other sources of aid. When lenders returned to school certification, PSL average sizes fell to 80% of tuition without any corresponding increase in the availability of federal loans for dependent undergraduates.<sup>161</sup> Therefore, the Sample Lender data suggests that DTC lending is correlated with

significant over-borrowing. Over-borrowing increases the likelihood of default, to the detriment of both borrower and lender.<sup>162</sup> Lenders have learned this lesson, returning to certification of over 90% of undergraduate loans.<sup>163</sup> But lenders' appetite for risk tends to ebb and flow – hence the concept of a credit *cycle* – and there is no assurance that, as memory of the financial crisis fades, lenders will stick to requiring certification. Public commenters from all constituencies, including lenders, suggested that school certification should be mandatory.

## **PUBLIC COMMENTS FROM CONSUMERS ARE CONSISTENT WITH EMPIRICAL DATA ABOUT CONSUMER RISKS.**

Almost 2000 individual borrowers and other consumers responded to a public notice published on November 17, 2011 seeking information to inform the preparation of this Report. While respondents are not a representative sample of the entire population of borrowers of private student loans, the responses illuminate some risks to consumers in the marketplace, particularly for borrowers who are struggling financially. Respondents expressed a mix of confusion, regret, and despondence about their current circumstances.

A critical theme was the inability to recognize the crucial differences between federal and private student loans. Some respondents discussed how they thought, or were told, that their private student loans would have the same features (e.g., deferment) as a federal student loan. Others pointed to the belief that they would not qualify for federal student loans and thought that a private student loan was an economic substitute. Some respondents remarked that private student loans were 'packaged' with federal student loans in their financial aid offer, potentially contributing to the economic substitute assumption.

Another theme that emerged was the challenge students experienced in gathering reliable information. Many respondents discussed how they were dependent on the school's financial aid office for information on student loans. Unfortunately, some respondents believed that the quality of information they received was inadequate. Whether or not this is true, it appears that schools, like brokers in other financial product markets, play a major role in the borrower's decision-making process.

Finally, many respondents discussed challenging repayment experiences with the servicer of their private student loan. As with other product markets, respondents described how they were unable to decipher why payment amounts would change and were unable to negotiate alternate payment plans in times of hardship. Others described lost payments and troubling debt collection experiences.

The Agencies did not seek to verify these comments or assess whether they reveal violations of law. Nor can these comments be assumed to be representative of the experience of PSL borrowers. What is clear, however, is that the complaints themselves evidence opportunities to improve customer satisfaction and reduce consumer harm among some borrower segments.

## **PRIVATE STUDENT LOAN DEBT RECEIVES VERY DIFFERENT TREATMENT IN BANKRUPTCY PROCEEDINGS COMPARED TO OTHER CONSUMER LOANS.**

Many private student loan borrowers entering the labor market in the wake of the recent recession have faced significant challenges, and many have defaulted on their PSLs. Bankruptcy discharge may be an essential protection against consumer injury that might otherwise result when a consumer lacks the income or other means to manage debt. However, that benefit generally does not apply to student loans.<sup>164</sup> These loans are virtually immune from discharge in bankruptcy.

Special bankruptcy treatment for some PSLs dates back more than 20 years. The preferential treatment for PSL obligations was originally limited to private student loans made by non-profit entities, such as schools. Beginning in 1985,<sup>165</sup> any loan guaranteed by a non-profit private guaranty agency was excluded from discharge in bankruptcy. This provision benefitted guarantees issued by nonprofits that were specially created to support PSLs.<sup>166</sup> Prior to 2005, many financial institutions used this provision to render their loans immune to bankruptcy discharge by purchasing a loan guaranty from a nonprofit, while others originated PSLs that were exposed to bankruptcy discharge.<sup>167</sup>

In 2005 the bankruptcy code was amended so that all loans made for a qualified education expense became exempt from discharge in bankruptcy absent “undue hardship” to the debtor and his/her dependents.<sup>168</sup> There is a heavy burden to prove “undue hardship.”<sup>169</sup> This burden is mitigated for federal student loan borrowers through various income-based repayment, forbearance, and deferral options authorized under Title IV that provide some alternative to bankruptcy relief. As discussed above, there are few similar repayment options for private student loans.

In contrast to student loans, the vast majority of consumer loans and other consumer credit products are dischargeable in bankruptcy. This includes secured loans like mortgages and auto loans, which are subject to repossession or foreclosure of the financed asset and completely unsecured loans like credit cards and so-called “signature loans.” The realm of non-dischargeable debts is limited, and includes child support payments, alimony, debts related to tax liens, claims arising out of wrongful conduct (like a judgment against a drunk driver), and both federal and private student loans. With the exception of private student loans, these debts have one of two primary characteristics, either they are owed to the public or the creditor lacks discretion over entering into the debtor-creditor relationship (or both). Federal student loans are owed to the government, and excluding them from bankruptcy discharge could be a method of defending the federal fiscal interest. The same rationale applies to tax liens. Child support payments are both an involuntary relationship for the children and a means of protecting the public fiscal interest because the State is generally responsible for children who lack financial support. Likewise, the victim of a drunk driver has no choice with regard to the debtor-creditor relationship.

There is little in the Congressional record surrounding the 2005 changes to the Bankruptcy Act regarding the rationale for treating private student loans similarly to federal student loans and differently from general consumer loans. Given this lack of explicit legislative intent, the Agencies attempted to determine whether an economic rationale for non-dischargeability of private student loans might be suggested by the available data. The remainder of this Part examines data on bankruptcy, credit availability, and loan pricing.

## DESPITE THE CHALLENGE OF DISCHARGING PSLs IN BANKRUPTCY, MORE STUDENTS ARE TURNING TO BANKRUPTCY FOR PROTECTION.

In light of the \$8.1 billion of Sample Lender Portfolio loans in default, it is clear that there are a significant number of borrowers who are currently unable to repay PSLs and have limited repayment or bankruptcy discharge options.<sup>170</sup> For these borrowers, the PSL obligation will remain with them indefinitely. Those who continue to be unable to make payments face the potential of an ongoing negative credit history which can, in turn, impede their ability to obtain employment, rent an apartment, purchase insurance, and, of course, access mortgage financing and other credit.

Some borrowers have elected to file for bankruptcy, even though they cannot discharge their student loan debt in the process. Table 18 shows the growth of loan volume in bankruptcy status for the Sample Lender Portfolio:

**TABLE 18: \$ VALUE OF PSLs IN A BANKRUPTCY STATUS AS OF THE END OF EACH CALENDAR YEAR FOR ALL REPORTED VINTAGES (1999-2011), GROSS DOLLARS AND PERCENTAGE OF OUTSTANDING BALANCE(SAMPLE LENDER PORTFOLIO)<sup>171</sup>**

Total \$ of Loans in Bankruptcy Status as of CY End (All vintages)						
2005	2006	2007	2008	2009	2010	2011
241.2	154.9	253.4	352.5	850.1	1,231.8	1,479.8

Loans in Bankruptcy Status as of CY End as a % of Total Outstandings						
2005	2006	2007	2008	2009	2010	2011
0.8%	0.4%	0.4%	0.5%	1.0%	1.2%	1.3%

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Source: Sample Lender Loan Level data

Over 1% of the total Sample Lender portfolio was in bankruptcy at the end of 2011.

We attempted to measure the trend in use of bankruptcy. Because the Sample Lender data does not connect originations to portfolio performance, we cannot test bankruptcy as a percent of origination cohorts. However, a comparison of the number



of dollars defaulting in each calendar year to the number of dollars in bankruptcy each calendar year is possible. The change in that ratio is an indicator of how many distressed borrowers have used bankruptcy even though it provides incomplete relief. Table 19 shows the ratio of annual dollars in default to annual dollars in bankruptcy.

**TABLE 19: \$ VALUE OF PSLs IN A BANKRUPTCY STATUS AS OF THE END OF EACH CALENDAR YEAR FOR ALL REPORTED VINTAGES (1999-2011), AS A PERCENTAGE OF DEFAULTED LOANS (SAMPLE LENDER PORTFOLIO)**

<b>Balance of Loans in Bankruptcy as a percentage of Defaulted Loans (Incidence)</b>						
Calendar Year End						
2005	2006	2007	2008	2009	2010	2011
174.0%	89.0%	51.6%	44.6%	39.9%	53.9%	69.0%

Source: Sample Lender Loan Level data

Our review of quarterly Sample Lender Portfolio data explains the spike in 2005-2006 filings. It reflects bankruptcy cases filed just before changes to the law went into effect.<sup>172</sup> Since then, use of bankruptcy declined initially but re-emerged significantly in 2010-2011, again despite the lack of discharge for student debt.

One hypothesis to explain this activity is that borrowers are using a Chapter 13 plan to reduce their current payments and eliminate current collection activity. As the recession and slow recovery produced sustained higher unemployment rates for recent graduates, more distressed borrowers chose the Chapter 13 option. However, a Chapter 13 filing only provides temporary payment relief. At the end of a Chapter 13 plan the PSL lender's rights are unchanged, and any accumulated, unpaid interest is added to the outstanding principal. An alternative hypothesis is that other, dischargeable debts or other circumstances (e.g. medical conditions) caused these student borrowers to seek bankruptcy protection. The Agencies do not have data to determine which hypothesis is more likely to be correct.

Current data is not sufficient to support a complete analysis of the current disparity in bankruptcy treatment between PSLs and other consumer loans.

After observing the frequent use of incomplete bankruptcy protection, the Agencies sought to determine whether the market benefits of the 2005 changes to the bankruptcy standard outweighed the harm to defaulted borrowers. We looked first for reduction in price or increased access for the less creditworthy as evidence that the market reacted to the 2005 change in the law in a way that would benefit consumers generally. The data we have does not show that changes to the bankruptcy standard in 2005 directly led to lower prices or wider access to credit.

The analysis did not detect any general downward movement of price immediately after the change to the law. Indeed, for loans governed by the 1-month LIBOR index the mean margin increased by 80 bps during 2005-2006.<sup>173</sup> This change may have

reflected higher prices due to weaker credits, or other factors that outweighed the positive credit effect of the law change. The data does not allow us to distinguish between causes. In addition, any decrease or change in general pricing might be masked by the pre-2005 availability of bankruptcy protection that was “purchased” from a nonprofit guarantor.<sup>174</sup> More importantly, any pricing effect of a change in bankruptcy protection might also be masked by the rapid growth of low cost capital from securitization in 2005-2006.

A similar uncertainty plagues any test of improved access to credit by the less creditworthy that might have been caused by the 2005 change. One contemporary analyst found negligible reductions in mean credit scores between 2004 and 2007 vintage securitizations, arguing from that data that the 2005 change did not improve access to credit.<sup>175</sup> If mean credit scores had declined, that would be evidence that credit was more accessible to the less creditworthy. The Sample Lender loan level data, however, do show a measurable decrease in mean credit scores during the period from 2005-2007, which would suggest increased access to credit.<sup>176</sup> As with price changes, however, it is impossible to distinguish between the effect of the bankruptcy law change and the broader effect of capital markets demand for PSL assets when determining the cause for lower mean credit scores.

Another approach to determining the market benefits from the special bankruptcy treatment of PSLs is to project the increased lender costs from higher frequency and severity of net defaults, absent the special rule. Given how recently the change was made, losses of bank lenders before and after the change could help measure the benefit of the rule. In addition, collection data for non-profit guarantors whose loans have been exempt from bankruptcy since 1985 would further refine that estimate.<sup>177</sup>

A third party analyst recently attempted to quantify the cost of a bankruptcy law change, analyzing the Sallie Mae portfolio of non-cosigned loans (those most likely to use a new bankruptcy relief). The analysis concluded that bankruptcy losses on a large existing loan portfolio would increase from 3.6% to 4.3% of loan balances, based on comparing pre- and post-2005 performance. The analyst estimated that this increase in bankruptcy filing rates, plus changes in the recovery rates, would increase charge-offs by \$75 million and decrease recoveries by \$78 million on a total base of \$10.8 billion in non-cosigned loans in repayment.<sup>178</sup> The analysis also concluded “though credit negative, we think the approximately \$150 million increase in net charge-offs is manageable relative to the company’s 2011 core earnings pre-tax income of \$1,491 million,” with even smaller effects on other large bank lenders where PSLs represent a smaller share of their overall business mix.<sup>179</sup> The analysis concluded that allowing private student loans to be discharged in bankruptcy could reduce future origination volume and lead lenders to adjust their pricing to account for the greater risk.<sup>180</sup> Some of the cost might be absorbed by lenders, given competition, but the rather thin market of PSL providers that exists today makes that less likely.

It is important to note that the foregoing analysis was limited to non-cosigned loans. It assumed that creditworthy co-signers would not have a need for bankruptcy relief. However, there may be a percentage of co-signed loans that belong in bankruptcy, because of labor market issues for both the primary borrower and the co-signer and

because of limitations on loan underwriters' ability to judge the overall educational indebtedness of students and their parents. In other words, some co-signers may be overloaded with education debt and others may have become long-term unemployed.

The Agencies are unable to predict precisely the outcome of an analysis of the costs and benefits of a bankruptcy law change. Such an analysis would compare that cost with the harm to those suffering from defaulted PSLs today who cannot escape the impact of the loans they cannot repay.

The Agencies also examined the discussion surrounding the moral hazard dimension that is a component of bankruptcy policy. The initial decision to make federal student loans virtually immune to bankruptcy discharge was based, in part, upon the perceived moral hazard inherent in encouraging a student to use credit to purchase a valuable intellectual asset which cannot be repossessed. Supporters of special bankruptcy protection claimed that students could discharge the financial obligation through bankruptcy after graduation, while reaping the financial benefits of the intellectual asset for a lifetime.<sup>181</sup> Proponents of the amendments to exempt federal loans from discharge stated that to remove them would mean that the Bankruptcy Code would then be "almost specifically designed to encourage fraud."<sup>182</sup> They also stated that there was a basis for separating educational loans from other types of debt because "the lack of collateral necessary for the educational loan is an indicator that educational loans do differ substantially from other forms of debt [and that] these bankruptcies could easily destroy the federal student loan programs, a harm that would be at least as great as the fraud-type problem."<sup>183</sup> Congress, through the GAO, has researched the impact of bankruptcy on the federal student loan program. In 1976, a GAO study was commissioned to test the need for the law change. The study did not report a large number of student loan bankruptcies.<sup>184</sup> In 1997, a review by the Congressionally-mandated National Bankruptcy Review Commission of 1997 did not find any systematic abuse of the bankruptcy system for student loan discharge.<sup>185</sup> In reviewing a 1991 GAO study, the National Bankruptcy Review Commission found that "only a fraction of 1% of all matured student loans were discharged in bankruptcy and that bankruptcy filings constituted only three to four percent of student-loan losses, a rate that compared favorably to the consumer credit industry overall."<sup>186</sup> These findings from the last century may not, however, reflect current economic conditions. The elevated level of private student loans currently in bankruptcy (1.3% of outstandings in the Sample Lender portfolio data) and the continuing aftereffects of the financial crisis and subsequent recession may represent a hitherto unknown potential impact of bankruptcy discharge on the student loan market. These macroeconomic effects, however, may not be permanent and thus may not significantly change the moral calculus of a future student considering the use of PSLs over an entire educational career.

The potential for moral hazard is different, however, for co-signed loans, which now make up more than 90% of PSLs made to finance undergraduate education. In contrast to the pre-credit student, the co-signer asks the lender to extend credit based on the proven income, assets, employment, and payment history of the co-signer. Both lender and co-signer expect that the co-signer can service the debt. That is the

purpose of a creditworthy co-signer. In this context, the argument for non-dischargeability as a control for moral hazard is unclear. The creditworthy co-signer has a lot to lose. Indeed, there is an argument that a co-signer is positioned like any other consumer borrower. The lender and borrower reasonably calculate that the borrower can repay the loan. If they miscalculate, both lose, and a bankruptcy discharge may be the ultimate (and appropriate) result. Finally, the co-signer who is a parent may provide a control on the theoretical moral hazard affecting the student, to the extent that parents have influence over financial behaviors of their children.

Thus, the theoretical moral hazard risks related to lending to a pre-creditworthy student and a creditworthy co-signer are very different, so a policy choice is further complicated when considering a loan to a combination of the two.<sup>187</sup>

The analysis of moral hazard around private student loan bankruptcy is complicated by procedural alterations to bankruptcy law made by Congress in 2005. These changes included adding a means test for individuals who attempt to obtain relief under Chapter 7.<sup>188</sup> Individuals whose income exceeds standardized expense amounts (based on surveys compiled by the Internal Revenue Service) cannot pursue relief under Chapter 7, and must proceed instead under Chapter 13. Arguably, a student intent on “strategic default” could attempt to take advantage of his or her Chapter 7 eligibility during a period of low income following graduation, but such a filing could be dismissed if it is considered by the court to be in “bad faith”<sup>189</sup> (as with any consumer debt under the new procedures). To obtain a full discharge in Chapter 13, the individual must successfully complete an approved 3 to 5-year repayment plan.<sup>190</sup> An excusable failure to make all payments can result in a more limited discharge.<sup>191</sup> A plan can be approved only if the individual commits to use all his or her “disposable income” - income net of those IRS-standardized expense amounts - to make the payments proposed under the plan.<sup>192</sup> These limits sharply restrict the discretion of the bankruptcy court to address individual circumstances. Lawyers for bankruptcy filers must now certify that they have determined, based on reasonable investigation, that debtor claims are legitimate, and can now face liability for costs and civil penalties for submissions based on false information.<sup>193</sup> The increased risk has resulted in an increase in the attorney fees charged to bankruptcy filers and more generally in considerable increase in the documentation required to support an application.<sup>g</sup> Thus, there is an argument that 2005 procedural changes affecting all consumer debts provide adequate controls for moral hazard and special treatment for PSLs is unnecessary. Additionally, these procedural changes may shift many potential Chapter 7 filers into Chapter 13, where creditors would have three to five years capture increases in income produced by higher education.

The 2005 general procedural changes also suggest that Congress might explore the type of relief that might be afforded to those currently in distress with PSLs. If Congress should find that the 2005 change did not provide the expected market

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<sup>g</sup> Lois Lupica, American Bankruptcy Institute National Conference of Bankruptcy Judges. The Consumer Bankruptcy Fee Study Final Report. December 2011. Available at: [http://bapcpastudy.files.wordpress.com/2011/12/cfsfinalreport\\_final\\_dec7.pdf](http://bapcpastudy.files.wordpress.com/2011/12/cfsfinalreport_final_dec7.pdf)

benefits, there may be a range of legislative improvements available, other than complete and immediate discharge in bankruptcy. The historical changes in treatment of student loans under the Bankruptcy Code provide examples. When limitations on bankruptcy protection from federal student loans were first adopted in 1976, Congress still allowed those students who tried to repay for a period of time (5-7 years) to obtain a discharge.<sup>194</sup> The same rules applied to non-profit lenders (schools) who had special bankruptcy treatment at that time. It was only in 1998 that the rule against discharge became virtually absolute.<sup>195</sup>

Drawing on this history, Congress might permit discharge of private loans after a period of time in repayment. Similarly, Congress could allow a bankruptcy filing after less than 5 years of repayment, but require the use of a Chapter 13 "wage earner" proceeding for 3-5 years to obtain a discharge of a private student loan. This procedure would allow the capture of the student borrower's increased earnings potential over a period of years before granting a discharge. Only where the educational investment truly produced insufficient returns to repay that investment would such a plan grant a discharge after less-than-full repayment. Recommendations based on the foregoing discussion are set forth at the conclusion of this Report.

# Part Four: Fair Lending Issues

This section examines issues identified in the statute that relate to private education loans and the Nation's fair lending laws, including:

- “the underwriting criteria used by private educational lenders, including the use of cohort default rate (as such term is defined in section 435(m) of the Higher Education Act of 1965);”
- “the terms, conditions, and pricing of private education loans;” and
- “whether federal regulators and the public have access to information sufficient to provide them with assurances that private education loans are provided in accordance with the Nation's fair lending laws and that allows public officials to determine lender compliance with fair lending laws.”

Private student lending presents complexities that are not generally present in other consumer debt products. In mortgage (and other secured) lending, the underlying value of a home (or other asset such as a car), the borrower's income, and the borrower's credit history are critical criteria in the underwriting process. In other markets where lending is not secured by an asset, as is the case with credit cards, lenders often rely on the ability to close or reduce lines of credit in addition to underwriting based on credit history and income. In contrast, a private student loan borrower pursuing postsecondary education full-time often lacks income and credit history. In addition, because loans are generally funded in full and payments are deferred, private student lenders lack the ability to limit or reduce an open line of credit. Accordingly, to the extent lenders underwrite on the basis of the student's application rather than the creditworthiness of a co-borrower, lenders must choose

some basis to distinguish borrowers who are more or less likely to repay out of a group of borrowers who have little to no credit history and whose future earnings are uncertain. Private student lenders have addressed these issues in recent years by requiring borrowers to either be independently creditworthy or have a creditworthy co-signer.

It may be reasonable to assume that future repayment ability is related to whether a postsecondary education program adequately prepares a student for gainful employment. As of the publication of this Report, the federal government does not publish data on the earnings of graduates by program. However, there are some statistics that may be correlated with the value of a degree from a particular school. For example, schools self-report graduation and retention rates to the Secretary of Education. The Department of Education also publishes a statistic called cohort default rate for each school participating in Title IV programs.

## COHORT DEFAULT RATE

Cohort default rate (“CDR”) is a measure of the federal student loan repayment history of a particular group or “cohort” of borrowers. For each school, the CDR is the percentage of the school’s borrowers entering repayment on federal student loans during a particular period who default prior to the end of the period. Currently, the period used to calculate CDR spans multiple federal fiscal years.

CDR is one tool used for determining a school’s eligibility for federal student loan programs. Currently, the Department of Education removes a school’s eligibility for those programs when the institution’s three most recent CDRs are above 25%, or where the most recent CDR is greater than 40%. The Department of Education uses CDR as an eligibility cutoff at these relatively high levels, because CDR is intended to be used as a broad measure to evaluate the risk to taxpayers of guaranteeing loans at a particular school. To that point, based on 2009 CDRs, published in 2011, only five schools were excluded due to the Department’s rules. As designed by Congress, CDR was not specifically intended to assist private lenders in eligibility, underwriting, and pricing decisions,<sup>196</sup> particularly at much lower levels of default (e.g. under 8%). However, CDR has been used by private student lenders seeking a proxy for a student’s likelihood of repaying.

## FAIR LENDING IMPLICATIONS

The Equal Credit Opportunity Act (“ECOA”) makes it illegal for a creditor to discriminate in any credit transaction against any applicant.<sup>197</sup> One form of discrimination recognized under the ECOA is disparate impact, which prohibits a creditor practice that has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the practice meets a legitimate business need that cannot reasonably

be achieved as well by means that are less disparate in their impact.<sup>198</sup> Federal regulators,<sup>199</sup> as well as the private bar,<sup>200</sup> have both recently pursued private student lending actions that implicate fair lending issues.

Private student lenders' use of CDR at very low default levels may present fair lending concerns because, as discussed below, racial and ethnic minority students are disproportionately concentrated in schools with higher CDRs. Accordingly, use of CDR to determine loan eligibility, underwriting, and pricing may have a disparate impact on minority students by reducing their access to credit and requiring those minority students who meet the lenders' eligibility thresholds to pay higher rates than are otherwise available to similarly creditworthy non-Hispanic White students at schools with lower CDRs.

## USE OF CDR BY PRIVATE STUDENT LENDERS

The Sample Lenders provided information about how they use CDR and other institution-based criteria to determine a student's eligibility for their loan programs, as well as underwrite and price their private student loans. In this context, the term "eligibility" refers to whether a lender accepts applications from a particular postsecondary school's students. If a lender set its eligibility cutoff at a CDR of 12%, then students from those schools with a rate at or below 12% would be eligible to be considered for a loan, whereas students from schools with a rate above 12% could not receive a loan, regardless of any particular student's creditworthiness (or that of his or her co-applicant).

The primary use of CDR by the Sample Lenders is to set such school eligibility cutoffs. Prior to the 2008 financial crisis, many Sample Lenders employed an eligibility cutoff between 10% and 12%. After the crisis, a majority of Sample Lenders report eligibility cutoffs in the range of 6% to 8%, though some lenders have moved in the opposite direction, increasing their cutoff as high as 20%. The majority of the Sample Lenders report relying almost exclusively on CDR to set their school eligibility cutoffs.<sup>201</sup> However, some Sample Lenders report setting eligibility cutoffs using CDR in conjunction with other factors such as internal portfolio performance, while others have phased out this particular use of CDR and replaced it with a school's graduation rate instead,<sup>202</sup> and others may have phased out use of school-specific criteria entirely.

In terms of underwriting and pricing, the Sample Lenders largely report utilizing traditional, individually-applied criteria, such as minimum FICO score or custom scorecard measures, debt-to-income ratio, payment-to-income ratio, length of credit history, number of trade lines, number of derogatory credit items, and delinquency/bankruptcy history. Moreover, the Sample Lenders report that in general private student loan borrowers must either be independently creditworthy or have a creditworthy co-signer. A few Sample Lenders, however, did report utilizing CDR as part of, if not the primary consideration in, their underwriting and pricing decisions. Most of these lenders created custom scorecards that included CDR as a factor, and used the scorecard for both underwriting decisions and determining pricing tiers.



## ACCESS TO DATA TO ASSESS FAIR LENDING COMPLIANCE

In the mortgage market, lenders are required to collect and report applicant demographic data in accordance with the Home Mortgage Disclosure Act.<sup>203</sup> No analog exists for private student loans. In fact, federal law generally prohibits lenders from collecting this data.<sup>204</sup> Accordingly, the public does not currently have complete information to assess whether a particular lender is in compliance with the nation's fair lending laws.

Federal banking regulators, in their role as supervisors of financial institutions, typically have the greatest access to lender data.<sup>205</sup> In order to conduct a robust empirical investigation of a lender's compliance with ECOA, they would be best served if they had the following types of data:

1. underwriting decisions and loan terms, including pricing
2. pricing grids or matrices
3. applicant credit characteristics, such as FICO score and debt-to-income ratio
4. applicant demographics, such as race and ethnicity

When applicant-level demographic data are not available, a common approach in fair lending analysis is to impute demographic characteristics based on the applicant's address—considering, for example, whether an applicant resides in a predominantly minority neighborhood. The inference of ethnicity from geographic data can have significant limitations, especially for PSLs made only to a student and not to a co-borrower, since students may use a temporary address, such as a dormitory or apartment near their school, when they apply for student loans. It may thus be difficult to accurately infer their demographic information from geographic data alone. Accordingly, data limitations may impact federal banking regulators' ability to evaluate a lender's compliance with the nation's fair lending laws.

## COHORT DEFAULT RATE AND SCHOOL RACIAL AND ETHNIC DEMOGRAPHICS

Despite the data limitations, some meaningful insights into the fair lending implications of private student lenders' use of CDR can be gained by examining the relationship between CDRs and minority enrollment at postsecondary schools, focusing on CDR based eligibility cutoffs used by the Sample Lenders.<sup>206</sup> One result is Table 20, which provides an aggregate demographic profile of postsecondary schools

by CDR range. It shows that African-American and Hispanic students are much more likely to attend schools with higher CDRs.<sup>207</sup>

As a next step, our analysis focused on the racial and ethnic distribution of students above and below the most commonly employed cohort default-rate cutoffs. Table 21 shows the average racial and ethnic make-up of schools in 2009, weighted by enrollment, with CDRs above and below 8%. It shows that African-American and Hispanic students are much more likely to attend schools with CDRs above the 8% eligibility threshold.<sup>208</sup>

**TABLE 20: PROPORTION OF STUDENT ENROLLMENT BY DEMOGRAPHIC GROUP AND CDR RANGE, 2008-2009 ACADEMIC YEAR**

	Percent of Students Who Attend Schools With CDR in A Given Range					Count
	0≤CDR<5	5≤CDR<10	10≤CDR<15	15≤CDR<20	20≤CDR≤100	
Total	42.2%	25.8%	23.2%	6.8%	2.0%	20,539,364
Gender						
Male	44.0%	25.2%	22.8%	6.1%	1.8%	8,793,497
Female	40.9%	26.2%	23.6%	7.2%	2.2%	11,745,867
Race <sup>a</sup>						
White	49.4%	25.1%	19.2%	5.5%	0.9%	6,904,535
Black	31.0%	28.1%	29.9%	7.9%	3.1%	1,530,810
Hispanic	35.4%	27.5%	30.0%	5.2%	2.0%	1,415,793
Asian	65.7%	19.2%	11.6%	3.1%	0.4%	712,844
Native American	44.3%	22.1%	23.2%	8.5%	1.9%	99,170
Unknown	39.9%	23.9%	22.0%	11.1%	3.1%	1,718,751

Source: IPEDS 2009 and PEPS.

Data are reported for the 50 States, the District of Columbia, Puerto Rico, and the territories.

<sup>a</sup>Students are not required to report race or ethnicity. Excludes students who report two or more races.

**TABLE 21: AVERAGE RACIAL AND ETHNIC DEMOGRAPHICS ABOVE AND BELOW 8%, BY SCHOOL TYPE, 2008-2009 ACADEMIC YEAR**

**2009 Demographic Distribution Below/Above 8% Threshold**

	Demographic Distribution Below 8%							Demographic Distribution Above 8%						
	Male	Female	White	Hispanic	Black	American Indian	Asian	Male	Female	White	Hispanic	Black	American Indian	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	44.0%	56.0%	60.5%	9.3%	10.0%	0.8%	6.6%	41.2%	58.8%	49.4%	17.0%	16.7%	1.0%	4.7%
School Type														
1-Public 4 Year	45.5%	54.5%	63.9%	8.7%	8.3%	0.8%	7.2%	40.8%	59.2%	46.6%	17.7%	25.1%	1.4%	2.7%
2-Pri 4 Year	42.6%	57.4%	60.6%	6.5%	8.8%	0.6%	6.0%	39.9%	60.1%	33.9%	33.2%	23.9%	0.7%	1.2%
3-Prop 4 Year	39.0%	61.0%	46.5%	7.9%	20.8%	0.7%	3.9%	35.2%	64.8%	33.4%	10.5%	23.3%	0.8%	2.4%
4-Public 2 Year	43.0%	57.0%	51.3%	15.4%	16.9%	1.3%	6.6%	43.1%	56.9%	55.0%	15.6%	12.4%	1.0%	5.9%
5-Pri 2 Year	28.3%	71.7%	63.8%	16.2%	10.9%	0.3%	3.3%	37.6%	62.4%	41.5%	17.9%	22.3%	0.5%	4.8%
6-Prop 2 Year	37.6%	62.4%	47.3%	23.9%	15.0%	0.9%	4.1%	36.1%	63.9%	37.7%	20.8%	24.2%	0.8%	3.2%
7-Pub < 2 Year	44.8%	55.2%	44.0%	33.3%	11.7%	4.3%	4.3%	35.7%	64.3%	70.8%	5.1%	19.8%	1.0%	1.0%
8-Priv < 2 Year	32.5%	67.5%	46.3%	22.5%	20.3%	0.5%	4.0%	54.8%	45.2%	12.8%	58.9%	20.7%	0.3%	6.9%
9-Prop < 2 Year	20.1%	79.9%	40.8%	26.4%	19.2%	0.5%	3.4%	28.0%	72.0%	30.2%	31.3%	26.4%	0.6%	2.6%

Source: IPEDS 2009 and PEPS. Data are reported for the 50 States, D.C., Puerto Rico, and the territories.

We also calculated odds ratios showing the relative likelihood, as compared to all students, that students of various racial and ethnic demographics would attend a school with a CDR above or below the industry's commonly used 8% and 12% eligibility thresholds.<sup>209</sup> Aggregating all schools, we found that African-American and Hispanic students were almost twice as likely as students generally to attend schools with a CDR above 8% than schools with a rate below the threshold. Moreover, a similar pattern was observed at the 12% CDR threshold.<sup>210</sup>

The results are even more pronounced when looking at specific types of schools. Results for the 2008-2009 academic year are presented in Table 22,<sup>211</sup> which shows that Hispanic students attending private four-year institutions were over seven times as likely as students generally to attend schools with a CDR above 8% than schools with a rate below the threshold; and African-American students attending Public four-year institutions were almost four times as likely as students generally to attend schools with a CDR above 8% than schools with a rate below the threshold.

**TABLE 22: ODDS-RATIOS FOR RACIAL AND ETHNIC DEMOGRAPHICS ABOVE AND BELOW 8% AND 12%, BY SCHOOL TYPE, 2008-2009 ACADEMIC YEAR**

2009 Distribution of race/gender group

Distribution	Odds Ratio above/below threshold 8%							Odds Ratio above/below threshold 12%						
	Male	Female	White	Hispanic	Black	Native	Asian	Male	Female	White	Hispanic	Black	Native	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	0.9	1.1	0.6	2.0	1.8	1.3	0.7	0.9	1.1	0.7	1.6	1.6	1.3	0.8
sec														
1-Public 4 Year	0.8	1.2	0.5	2.3	3.7	1.8	0.4	0.9	1.1	0.6	0.7	3.9	1.5	0.5
2-Pri 4 Year	0.9	1.1	0.3	7.2	3.3	1.2	0.2	1.0	1.0	0.1	19.4	3.5	0.6	0.1
3-Prop 4 Year	0.8	1.2	0.6	1.4	1.2	1.1	0.6	1.0	1.0	0.7	1.6	0.9	1.2	0.7
4-Public 2 Year	1.0	1.0	1.2	1.0	0.7	0.8	0.9	1.0	1.0	1.1	1.0	0.8	1.3	1.0
5-Pri 2 Year	1.5	0.7	0.4	1.1	2.3	1.8	1.5	1.2	0.8	0.3	2.8	1.4	1.8	1.1
6-Prop 2 Year	0.9	1.1	0.7	0.8	1.8	0.9	0.8	0.9	1.2	0.7	1.0	2.0	0.9	0.5
7-Pub < 2 Year	0.7	1.5	3.1	0.1	1.9	0.2	0.2	0.6	1.7	4.4	0.1	0.6	0.2	0.3
8-Priv < 2 Year	2.5	0.4	0.2	5.0	1.0	0.5	1.8	1.4	0.7	0.2	2.2	1.7	0.8	2.5
9-Prop < 2 Year	1.6	0.6	0.6	1.3	1.5	1.2	0.8	1.1	0.9	0.8	0.6	2.1	1.4	1.1

Source: IPEDS 2009 and PEPS. Data are reported for the 50 States, D.C., Puerto Rico, and the territories.

## CONCLUSION

To be clear, these findings do not imply that there is a causal link between minority enrollment and performance on federal loans. However, based on the observed correlation between a school's CDR and minority student enrollment, as well as the odds ratios calculated in our analysis, lenders' consideration of CDR in either school eligibility or underwriting/pricing criteria may reduce credit access and increase prices for minority student borrowers. The Department of Education uses CDR as a school eligibility cutoff at relatively high levels because CDR is intended to be used as a broad measure to evaluate risk to taxpayers of guaranteeing loans at a particular school. Schools with a CDR above these levels may fairly be viewed as failing to improve the income and employment prospects of their students. Thus, by limiting the extension of credit at such schools the Department's policy may serve a consumer protection function as well. However, as designed by Congress, CDR was not specifically intended to assist private lenders in eligibility, underwriting, and pricing decisions, particularly at lower levels of default (e.g., under 8%). Accordingly, the Sample Lenders' general reliance on CDR to set eligibility cutoffs for their loan programs may raise a threshold fair lending concern, requiring further analysis by lenders to provide evidence of a legitimate business need to use CDR. The Agencies are mindful, however, that our study lacked application-level data, which limited the authors' ability

to draw definitive conclusions about the above referenced fair lending implications of CDR.

While the previously articulated risks associated with PSLs generally make federal loans a better choice for consumers, the availability of such loans is statutorily limited, and they do not cover the full cost of attendance at many schools. Accordingly, PSLs can be an important tool in the education finance toolbox. Given that reality, it is important that lenders offer this product in accordance with the nation's fair lending laws.

# Part Five:

## Recommendations

### **RECOMMENDATIONS FROM THE DIRECTOR OF THE CONSUMER FINANCIAL PROTECTION BUREAU**

The Consumer Financial Protection Bureau opened its doors almost a full year ago. In the private student lending industry, we have sought to increase transparency, ensure compliance with existing laws of financial institutions, and educate the public on how to make better decisions.

Congress can also help to make this market work better for students, families, schools, and financial institutions. Below we identify some areas where Congress could help to modernize our nation's laws to meet the needs of today's marketplace.

#### **I. REQUIRING SCHOOL CERTIFICATION OF PRIVATE STUDENT LOANS COULD REDUCE OVER-BORROWING AND LEAD TO BETTER PRODUCT CHOICES.**

Congress should consider requiring lenders to better coordinate with institutions of higher education prior to originating a private student loan. Lenders should obtain an affirmative certification from the institution of higher education that the loan amount does not exceed student need.

As we discuss in this study, students currently complete a “self-certification” form. This additional paperwork may not spur meaningful conversation between schools and students about various grant and loan options that may have more favorable terms. A wide number of industry and student advocates have expressed support for schools playing a greater role in this process than is presently contemplated by the statute.

A potential solution might leverage the use of existing electronic networks among lenders and schools – replacing self-certification with mandatory certification like that formerly used in the FFEL program.

## **II. DETERMINE WHETHER CHANGES ARE NEEDED TO THE TREATMENT OF PRIVATE STUDENT LOANS IN BANKRUPTCY PROCEEDINGS.**

Federal student loans under Title IV of the Higher Education Act offer significant options for borrowers facing economic distress, including the ability to cap payments as a percentage of discretionary income and remain in good standing. While this may lead to greater total payments over the life of these loans, the borrower can more easily avoid the economic consequences of delinquency or default.

We heard from many distressed student loan borrowers facing trouble making payments on private student loans due to limited options for alternate payment options. Consumers, as well as businesses, have been able to restructure other types of debts through bankruptcy as a last resort.

But with less guaranteed flexibility compared to federal loans and very limited bankruptcy options compared to other consumer loans, private student loan borrowers facing tough economic times may be challenged to emerge as productive contributors to our society.

As noted in the report, several bodies were unable to find any systematic abuse of the bankruptcy code in seeking student loan discharges. Additionally, we were unable to find strong evidence that the 2005 changes to the bankruptcy code caused prices to decline or access to credit to increase significantly. If Congress concludes that the 2005 changes did not meet their overall policy goals, it would be prudent to consider modifying the code in light of the impact on young borrowers in challenging labor market conditions.

## **III. CONSIDER MODERNIZING AND CLARIFYING THE DEFINITION OF A PRIVATE STUDENT LOAN UNDER THE TRUTH-IN-LENDING ACT.**

Currently, the law generally defines a private student loan as a closed-end loan for postsecondary expenses not borrowed through programs under Title IV of the Higher Education Act.

However, there are other student loan programs issued by the federal government. For example, the Department of Health and Human Services offers loans to students pursuing health professions. These loans do not appear to involve the policy issues that prompted the addition of consumer protections in the past decade to private student loans.

On the other hand, there may be other products in the marketplace that serve as economic substitutes (such as lines of credit for postsecondary expenses) that do not meet the statutory definition, but may require a similar disclosure and consumer protection framework. Congress may wish to clarify these definitions to enhance consumer clarity and ensure a competitive, level playing field.

#### **IV. PROVIDE MECHANISMS FOR BORROWERS TO UNDERSTAND A COMPLETE PICTURE OF THEIR STUDENT LOANS.**

Input received from industry, schools, and consumers, reveals that many borrowers appear to view federal and private student loans as direct economic substitutes. Many borrowers do not have a clear understanding of the key differences between these loans. This leads to a further problem: because many borrowers have both types of loans from the same lender, many borrowers are confused about how much they owe and to whom, even as they decide whether to take on more debt for additional years in school.

Borrowers are able to determine their full set of federal student loan obligations by accessing the National Student Loan Data System (NSLDS). No such centralized, publicly-accessible system exists for borrowers of private student loans. Congress should explore how it can facilitate greater transparency of existing obligations and promote borrower understanding of their total debt obligations.

#### **V. DETERMINE WHETHER ADDITIONAL DATA IS NEEDED TO ENHANCE CONSUMER DECISION-MAKING AND LENDER UNDERWRITING.**

In order to make informed decision-making on appropriate levels of student debt, consumers need more and better information about post-graduation outcomes, such as employment and wage expectations by program of study, before they decide on which school to attend or continue attending.

The lack of data also impacts lenders. The scarcity of publicly-available data may contribute to the use of indicators such as cohort default rate and graduation rates in underwriting. While these may serve as proxies for expected outcomes, they may be far inferior to actual expected outcomes for the purpose of underwriting. Additional outcome data might also give the public and federal regulators greater confidence that underwriting is in compliance with the nation's fair lending laws.



# RECOMMENDATIONS OF THE SECRETARY OF EDUCATION

## I. WE RECOMMEND THAT CONGRESS REQUIRE INSTITUTIONS OF HIGHER EDUCATION AND PRIVATE EDUCATION LENDERS TO WORK PROACTIVELY TO PROTECT AND INFORM PRIVATE STUDENT LOAN BORROWERS.

- Require institutions of higher education to determine whether a private education loan borrower has exhausted his or her eligibility for Federal student aid and to certify a borrower's need for a private education loan before a private education lender issues the loan.

Some private student loan borrowers do not apply for Federal student aid, and many private student loan borrowers do not exhaust their Federal student loan limits. Because the terms and conditions of a private student loan are almost never as beneficial to a borrower as a title IV loan, it is important that students turn first to Federal student loans and other Federal aid to finance their higher education. We recommend that Congress require institutions to determine whether private loan borrowers have applied for and exhausted their eligibility for Federal aid, and if they have not, to disclose to borrowers their possible eligibility for Federal student aid, the terms and conditions of such aid, and that eligibility for Federal aid should be exhausted before borrowing a private education loan. We further recommend that the disclosure include an affirmation, signed by the borrower that the borrower has received the above information and that the borrower has exhausted his or her eligibility for Federal student aid or that the borrower has intentionally declined to either apply for Federal student aid or exhaust eligibility. Requiring a signed disclosure will ensure that borrowers are aware of and receive information about Federal student aid and that the financial aid office at the institution has a more complete picture of the borrower's educational financing and can counsel the borrower appropriately.

We also recommend that Congress require an institution that has accepted the borrower for enrollment to certify all private education loans, which would consist of verifying a student's enrollment, private student loan amount, and that the institution has determined that the amount of loan requested does not exceed the amount of the applicant's qualified educational expenses net of Federal or other student financial assistance available or awarded to the applicant. We recommend requiring that the private lender obtain this certification from the institution before making a private loan and that the loan amount not exceed the amount certified by the institution.

While the current trend in private education lending is for the school at which the borrower is enrolled to certify a borrower's need for a private education loan, there is no guarantee that the direct-to-consumer (DTC) loan market of the near past will not reemerge as the economy improves. We believe that institutional certification of private education loans will cap the annual loan amount at cost of attendance less aid received and protect borrowers from overborrowing. As noted in the Consumer

Protection narrative in Part Three of this report, public commenters from all constituencies suggested that institutional certification of a private education loan should be required by law as a prerequisite to the making of a private student loan.

- Require lender disclosures on the availability of Federal student aid.

As noted above, it is critical that students and their families know that Federal student financial aid is available to finance higher education, most often with more generous terms, conditions, and repayment options than private student loans, and that they should only consider obtaining a private education loan if they have exhausted their eligibility for Federal grants, work-study, and loans, as well as State and institutional grants and scholarships where available. We recommend that Congress require private education lenders, before a private education loan is issued, to disclose to the borrower his or her possible eligibility for Federal student aid, the terms and conditions of Federal aid, that the borrower should exhaust his or her eligibility for Federal student aid before borrowing a private education loan, and that the borrower should contact the financial aid office at the school at which the borrower is enrolled for more information. Requiring private education lenders to make these disclosures before the loan is issued will ensure that a borrower is aware of and receives information about Federal student aid and will reinforce the notion that maximizing Federal student loans and other aid before borrowing a private education loan is more beneficial to the borrower.

## **II. WE RECOMMEND THAT CONGRESS WORK WITH THE CFPB AND THE DEPARTMENT OF EDUCATION TO DETERMINE HOW TO AFFORD GREATER FLEXIBILITY AND/OR RELIEF TO PRIVATE STUDENT LOAN BORROWERS WHO ARE EXPERIENCING FINANCIAL DISTRESS, INCLUDING POTENTIAL CHANGES TO THE TREATMENT OF PRIVATE STUDENT LOANS IN BANKRUPTCY PROCEEDINGS.**

Private student loans do not offer any of the debt management or mitigation options enjoyed by Federal loan borrowers, such as a variety of flexible repayment plans, forbearance options, and contractual rights to periods of loan deferment, rehabilitation, and forgiveness opportunities. These options, which extend for the life of a borrower's Federal student loan, provide relief from economic hardship for borrowers in extreme financial distress. Moreover, since 2005, private education loans are not dischargeable in bankruptcy unless the borrower can demonstrate undue hardship (like Federal student loans), an extremely difficult standard to meet.

The absence of consumer protections on private loans comparable to that available on Federal student loans, combined with the current restriction on bankruptcy discharge, leave those private student loan borrowers who face extreme financial distress with no last resort for economic relief, even in dire circumstances, such as borrower death on cosigned loans. The impact of having no last resort relief for private student loan borrowers is reflected in the relatively higher loan default rate among those borrowers that received a private student loan in the mid-2000s — a time when private loan

marketing was particularly aggressive and underwriting standards were less stringent than today.

In commissioning this report, Congress tasked the CFPB and the Department to examine the consumer protections available on private student loans, as well as their terms, conditions, and pricing. Based upon the substantial data provided in this report, and as the CFPB's recommendations note, there is no strong evidence that the 2005 changes to the bankruptcy code caused prices to decline or significantly increased access to credit. Nor did analysis by others find evidence of systematic abuse of the bankruptcy code in seeking student loan discharges when such an opportunity was more widely available.

Therefore, Congress should work with the CFPB and the Department of Education to determine what safeguards are adequate to ensure that students' and families' pursuit and attainment of postsecondary education, including when financed through the use of credit beyond Federal loans, do not jeopardize borrowers' ability to recover from severe financial distress. This determination should weigh the relative impact of providing student loan consumers with flexibility and relief—including forbearance, deferment, income-based repayment options, defaulted loan rehabilitation, and modifications to bankruptcy discharge provisions—with the potential that such safeguards may lead to higher prices or more stringent underwriting standards.

### **III. WE RECOMMEND THAT CONGRESS AMEND THE DEFINITION OF PRIVATE EDUCATION LOAN TO EXCLUDE OTHER FEDERAL EDUCATION LOANS.**

We agree with the CFPB that the definition of private education loan should exclude Federal education loans such as health profession loans made by the Department of Health and Human Services. Should Congress decide to change the law, we also recommend that Congress consider excluding only private education loans made by eligible not-for-profit holders as long as the following controlling factors are mandated to protect borrowers: a ban on price discrimination based on a borrower's credit worthiness; a requirement that repayment safety nets such as deferment, forbearance, and income-based repayment are included in the terms and conditions of the loan; and, a mandate that loan forgiveness be provided for public service such as teaching, nursing, and social work.

### **IV. WE RECOMMEND THAT THE DEPARTMENT OF EDUCATION AND THE CFPB WORK WITH CONGRESS TO IDENTIFY THE NECESSARY RESOURCES TO PROVIDE A COMPREHENSIVE PICTURE OF STUDENT BORROWING THAT IS INCLUSIVE OF BOTH FEDERAL AND PRIVATE STUDENT LOANS. THE ABILITY FOR A BORROWER TO ACCESS THIS INFORMATION IN A CENTRALIZED WAY WOULD HELP FACILITATE BETTER DEBT MANAGEMENT AND IMPROVED FINANCIAL DECISION MAKING.**

While student borrowers can access information about their individual federal student loan borrowing through the National Student Loan Data System (NSLDS), private

student loan borrowers have no such comparable resource. Additionally, there is no comprehensive resource that allows a complete picture of borrowers' student loan debt inclusive of all of their educational debt obligations.

We encourage the Department and the CFPB, working with Congress, to establish a centralized, publicly accessible, privacy-protected system for borrowers to access private student loan data that is comparable and compatible with ED's NSLDS. The information in NSLDS is a critical resource in the Department's management and operation of the title IV loan programs and facilitates ED's oversight and enforcement efforts as well. NSLDS underpins the efforts of our Student Loan Ombudsman in helping borrowers work through the problems they encounter in repayment and helps to ensure that student loan borrowers are aware of their Federal debt levels. Private lenders and private loan borrowers would be well-served by a comparable and compatible resource like NSLDS.

# Data Appendix I: Further Information About Data Sources

## MERGE METHODOLOGY

### DATA SOURCES

- Lender Loan Level Origination Data (Loan-Level Data)
- Integrated Post-Secondary Educational System (IPEDS)
- Postsecondary Education Participants System (PEPS)
- Consumer Price Index-All Urban Consumers (CPI-U)

### PROCEDURE

In order to obtain additional detail about school characteristics the loan-level data was merged with the IPEDS and PEPS data for corresponding years. The CPI was merged to the loan-level data in order to inflation adjust dollar values such as tuition and fees and original balances.

The relevant IPEDS was downloaded as custom datasets from the IPEDS Data Center (<http://nces.ed.gov/ipeds/datacenter/>) between March 14, 2012 and April 10, 2012 for academic years 2004 through 2011 (the 2011 data was early release data at the time it was downloaded). While OPEID is a variable in IPEDS, it is not reported by all institutions in all years.

For each school, tuition and fee variables were created for in-state and out-of-state students for each type of program by summing tuition and fees for each type of

program (for schools that only reported a comprehensive fee this was taken to be the tuition and fee value) using the `tuition1-tuition7`, `fee1-fee7`, and `cmpfee1-cmpfee3` for undergraduate and graduate students. For medical students, in-state tuition and fees were constructed using `isprof3`, `isfee3`, `osprof3`, and `ospfee3`, and similarly, for law students, tuition and fees were constructed using `isprof9`, `isfee9`, `osprof9`, and `osfee9`. These variables are only available through the 2010-2011 academic year. For undergraduates, published tuition and fees are available through the 2011-2012 academic year, and are constructed as separate variables using `chg2ay3`, `cmp2ay3`, `chg3ay3`, and `cmp3ay3`.

A crosswalk between IPEDS `unitid` and OPEID was created by taking the first non-missing OPEID associated with a particular school as the OPEID of the school if it was not reported in a given year. For the 53,717 school-year pairs in the IPEDS sample, this crosswalk updated OPEID in 24,415 (45.5%) of the records.

Retrospective IPEDS data, such as enrollment and average tuition, was assigned to quarter of origination based on reporting year (`fyrpyear`) for academic years 2004-2005 through 2009-2010: for a July 1 through June 30 calendar year quarters 1 and 2 of the survey year were assigned an origination year the same as the survey year and quarters 3 and 4 were assigned to an origination year a year earlier than the survey year; for institutions with a September through August reporting period, quarters 1, 2, and 3 were assigned to the same origination year as the survey year and quarter 4 was assigned to an origination year a year earlier than the survey year. For 2010 and 2012, all institutions conform to a July 1 through June 30 calendar year. A dataset was then created. The IPEDS dataset was merged with the loan-level data using 8-digit OPEID and quarter of origination, resulting in a match for 4,710,426 (86.3%) of the loan-level records and additional matching on 6-digit OPEID and quarter of origination resulted in 1 additional match. Records that did not match include consolidation loans; loans for foreign institution and other non-IPEDS reporting schools such as extension schools and test-prep programs; and schools that may have been miscoded and that could not be matched on name because of non-standard spelling. Once the merge was completed a borrower's relevant tuition and fees were calculated based on in-state status (a student is classified as in-state if the state in which his school is located and the state reported in the loan-level data matched; he is classified as out-of-state otherwise), and the corresponding in-state and out-of-state tuition and fees.

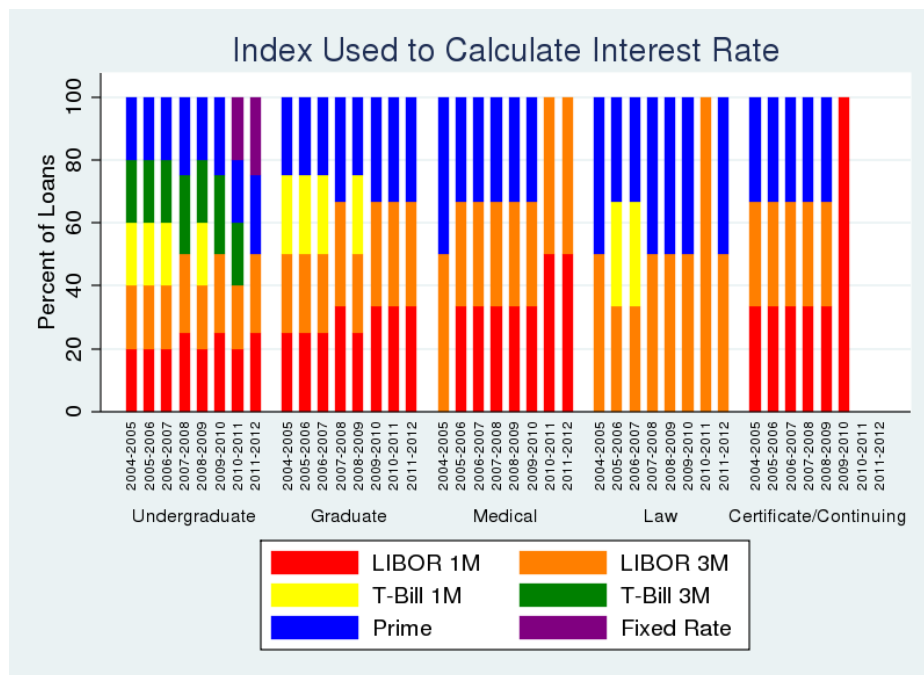
The loan-level dataset was also merged to the PEPS data provided by the third party aggregator (which they also used to verify OPEID) in order to add institutional variables that are not available in the IPEDS data, such as foreign institution status. This resulted in a match of 4,960,358 (90.9%) of the loan level records. All records that merged successfully with IPEDS also merged successfully with PEPS.

In order to inflation-adjust variables such as original loan balances and tuition and fees, the loan-level was also merged with the half-yearly CPI-U data on origination quarter where the first two quarters of a calendar year were attributed to the 1<sup>st</sup> half and the last two quarters of a calendar year were attributed to the second half. For all inflation-adjusted values, the base half-year is the second half of 2011.

In the loan level data, program type was imputed for records with missing values where the borrower reported attending the same educational institution in the record that immediately chronologically precedes the record with the missing value by attributing the next earliest non-missing response of program type for that borrower-lender pair at that institution. As a result of this procedure, program type was imputed in 40,539 records.

# Data Appendix II: Additional Figures And Tables

**APPENDIX FIGURE 1:** DISTRIBUTION OF INTEREST RATE INDICES BY PROGRAM TYPE (SAMPLE LENDERS)

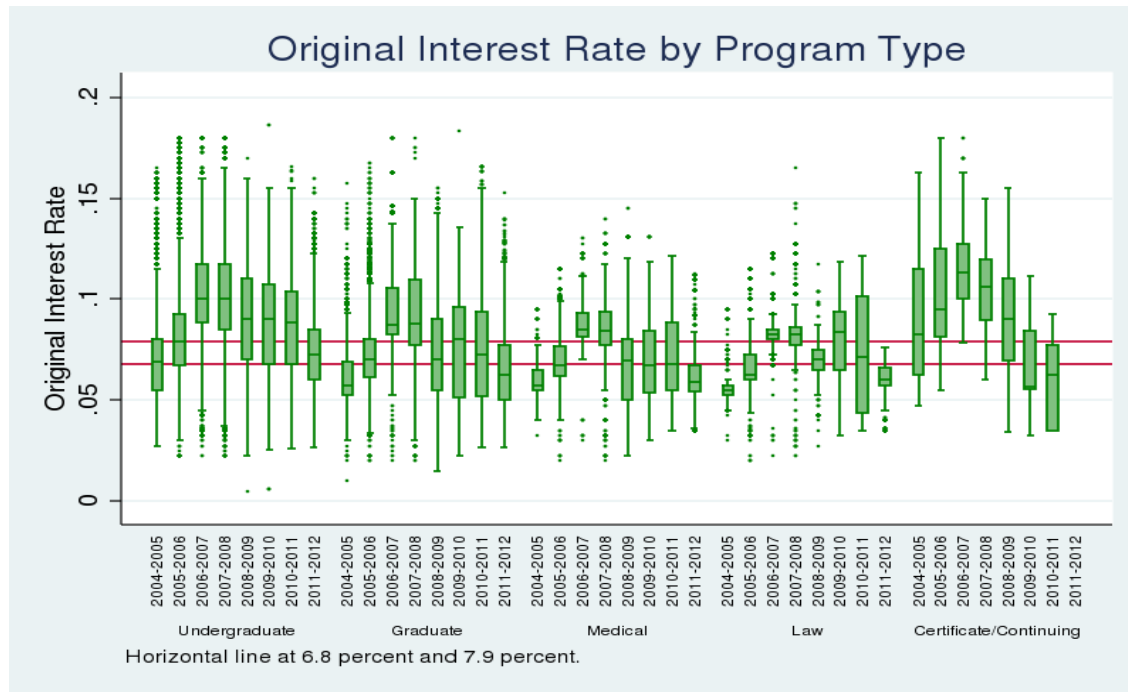




Source: Sample lender loan level data

Please note that T-bill based indices have largely disappeared as of the 2011-2012 academic year while fixed-rate offerings are just beginning to appear in undergraduate offerings in the Sample Lender loan level data. The key indices that persist through the Sample time period are Prime, and both LIBOR indices.

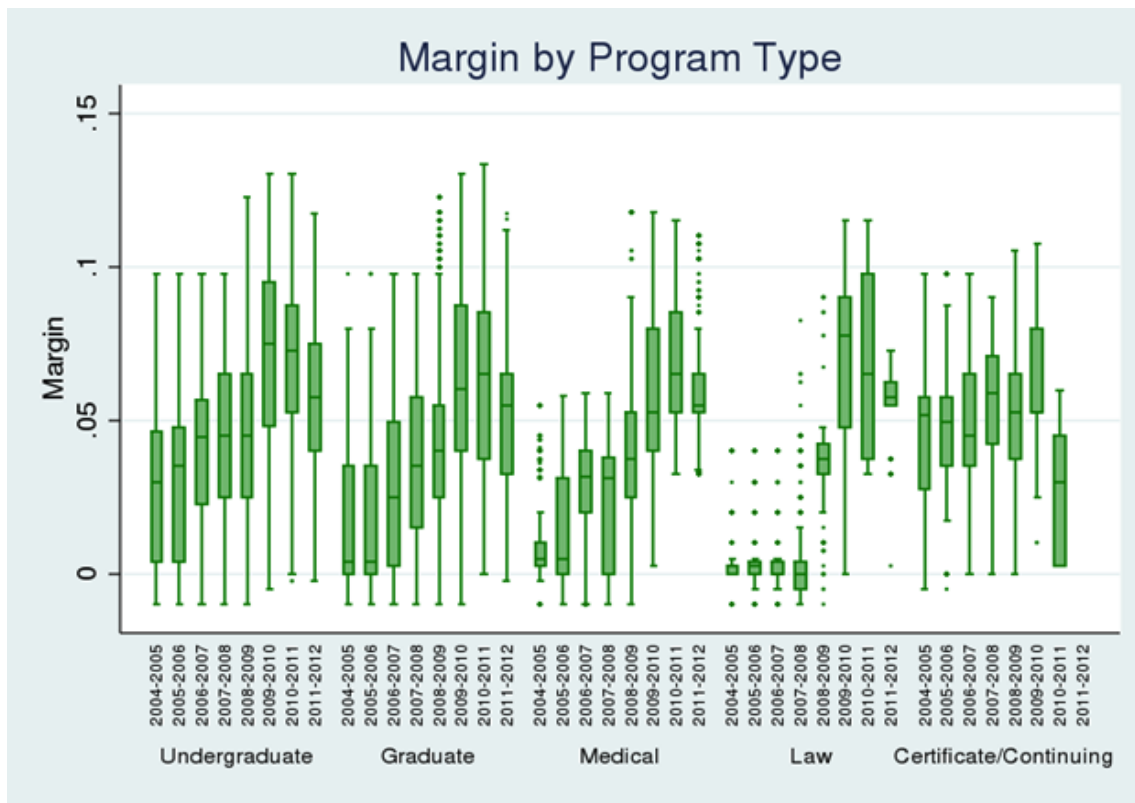
**APPENDIX FIGURE 2: DISTRIBUTION OF ORIGINAL INTEREST RATE BY PROGRAM TYPE (ACADEMIC YEAR BASIS) (SAMPLE LENDERS)**



Source: Sample lender loan level data

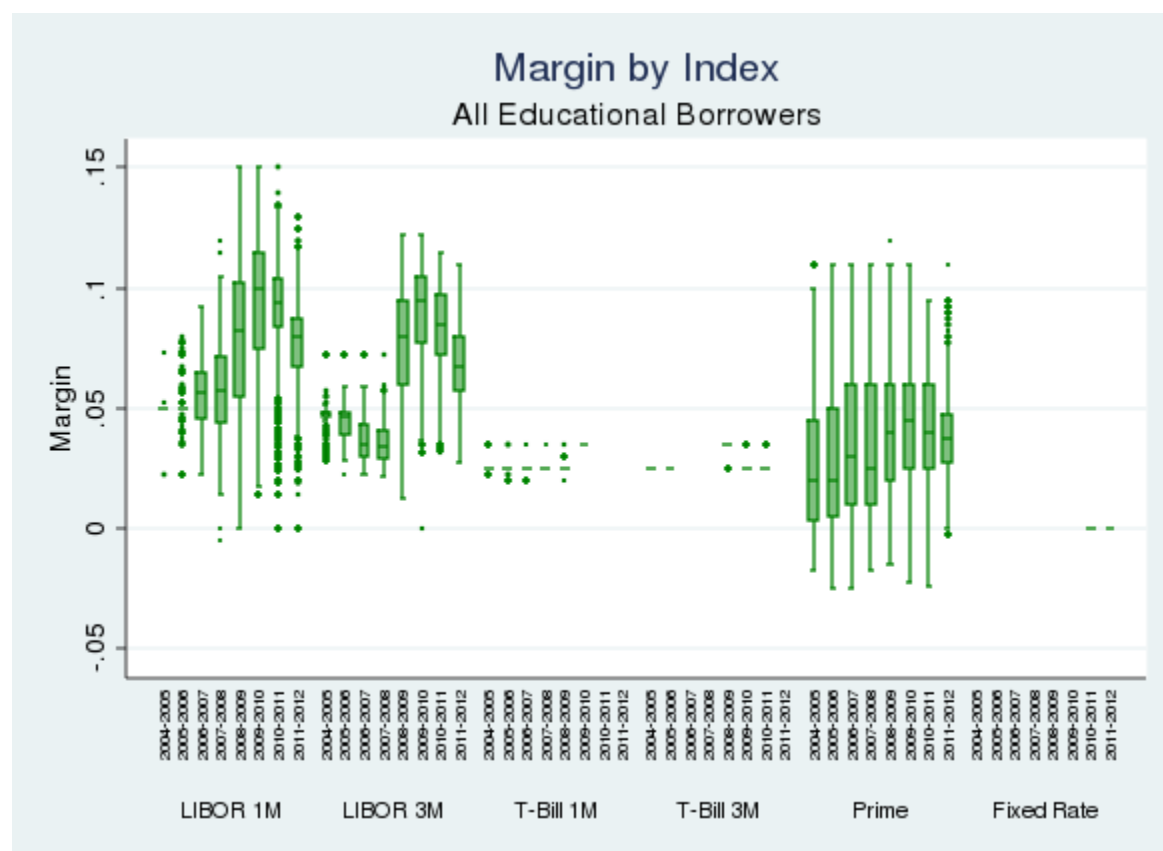
The two horizontal red lines in the figure correspond to the 6.8% fixed interest rates on federal Stafford loans and the 7.9% interest rate on federal Direct PLUS loans, both applicable as of this writing. Appendix Figure 3 presents box plots of the margin over the index used to compute interest rates by program type and year. Appendix Figure 4 presents box plots of the margin over the index used to compute interest rates by the index used. The variable-rate loan contracts used by PSL lenders compute interest at a rate that is reset periodically by adding the current value for the Index (such as the Prime Rate) plus a fixed "margin." The higher the margin, the higher the interest rate will be.

**APPENDIX FIGURE 3:** DISTRIBUTION OF MARGIN TO INDEX BY PROGRAM TYPE (ACADEMIC YEAR BASIS) (SAMPLE LENDERS)



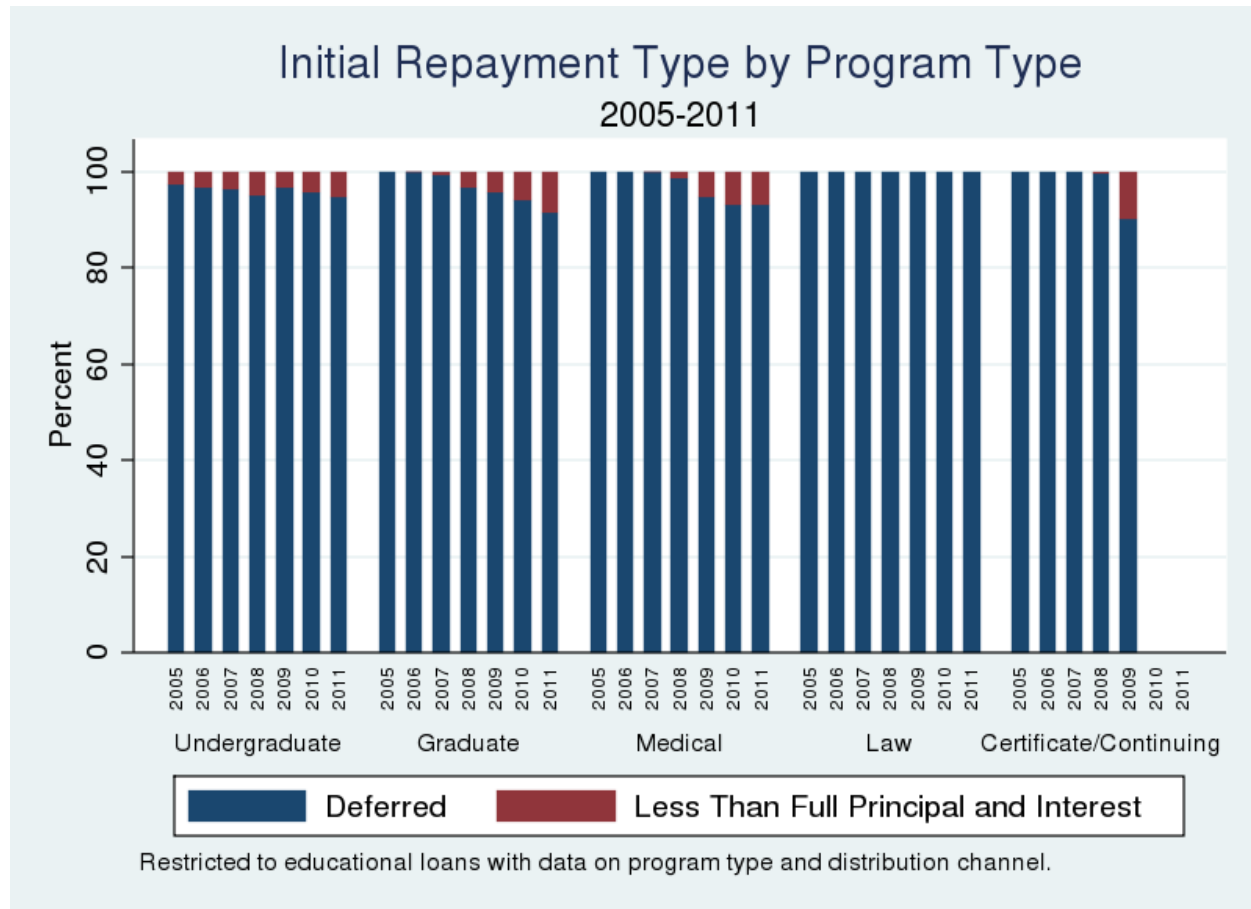
Source: Sample lender loan level data

**APPENDIX FIGURE 4:** DISTRIBUTION OF MARGIN BY INDEX  
(ACADEMIC YEAR BASIS) (SAMPLE LENDERS)



Please note that in each of the three key indices, Prime and both LIBOR (key in that they persist through our Sample period) margins rose during the financial crisis of 2008 and subsequently declined to a lower, but elevated (relative to the pre-crisis period) level.

**APPENDIX FIGURE 5:** CHANGE IN INITIAL REPAYMENT CHOICE BEHAVIOR BY ACADEMIC PROGRAM (CALENDAR YEAR) (SAMPLE LENDERS)



Source: Sample lender loan level data

**APPENDIX FIGURE 6: SUPPLEMENTAL DATA FROM PART FOUR –  
DEMOGRAPHIC DISTRIBUTION BELOW/ABOVE CDR THRESHOLD.**<sup>212</sup>

**2009 Demographic Distribution Below/Above 12% Threshold**

	Demographic Distribution Below 12%							Demographic Distribution Above 12%						
	Male	Female	White	Hispanic	Black	American Indian	Asian	Male	Female	White	Hispanic	Black	American Indian	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	43.3%	56.7%	58.0%	11.4%	11.6%	0.8%	6.1%	40.8%	59.2%	48.0%	16.9%	17.3%	1.1%	4.8%
School Type														
1-Public 4 Year	44.9%	55.1%	61.6%	10.3%	10.1%	0.9%	6.6%	41.5%	58.5%	49.8%	7.5%	30.4%	1.3%	3.7%
2-Pri 4 Year	42.4%	57.6%	59.8%	7.2%	9.7%	0.6%	5.7%	41.7%	58.3%	7.9%	60.0%	27.1%	0.4%	0.6%
3-Prop 4 Year	36.5%	63.5%	40.5%	7.7%	23.4%	0.7%	3.3%	35.9%	64.1%	33.5%	11.7%	22.0%	0.8%	2.4%
4-Public 2 Year	43.2%	56.8%	53.6%	15.5%	14.2%	1.0%	6.1%	42.9%	57.1%	54.9%	15.7%	12.3%	1.2%	6.0%
5-Pri 2 Year	31.8%	68.2%	59.9%	13.4%	15.3%	0.3%	3.9%	36.0%	64.0%	28.4%	30.0%	20.6%	0.6%	4.3%
6-Prop 2 Year	38.4%	61.6%	45.2%	21.4%	15.9%	0.9%	4.6%	34.8%	65.2%	35.1%	21.4%	27.5%	0.7%	2.4%
7-Pub < 2 Year	43.5%	56.5%	48.5%	26.9%	15.1%	3.6%	3.6%	31.1%	68.9%	80.6%	5.1%	9.9%	0.7%	1.2%
8-Priv < 2 Year	41.6%	58.4%	39.6%	34.5%	16.7%	0.4%	3.5%	49.3%	50.7%	12.5%	53.3%	25.2%	0.3%	8.3%
9-Prop < 2 Year	24.9%	75.1%	35.2%	35.7%	18.1%	0.5%	2.7%	27.2%	72.8%	30.5%	24.3%	31.2%	0.7%	2.9%

**2008 Demographic Distribution Below/Above 8% Threshold**

	Demographic Distribution Below 8%							Demographic Distribution Above 8%						
	Male	Female	White	Hispanic	Black	American Indian	Asian	Male	Female	White	Hispanic	Black	American Indian	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	43.5%	56.5%	60.5%	9.8%	10.3%	0.8%	6.4%	40.5%	59.5%	50.4%	16.7%	16.6%	1.0%	5.1%
School Type														
1-Public 4 Year	45.1%	54.9%	63.6%	9.6%	8.4%	0.8%	7.0%	40.4%	59.6%	49.6%	10.4%	29.8%	1.4%	2.9%
2-Pri 4 Year	42.4%	57.6%	61.7%	6.9%	8.8%	0.6%	5.8%	41.6%	58.4%	25.7%	37.3%	26.3%	0.4%	1.4%
3-Prop 4 Year	38.3%	61.7%	39.6%	6.6%	21.7%	0.7%	3.4%	34.3%	65.7%	38.2%	10.9%	20.3%	0.8%	2.8%
4-Public 2 Year	42.6%	57.4%	54.8%	13.7%	15.5%	1.2%	6.6%	42.6%	57.4%	55.7%	16.9%	11.9%	1.1%	6.3%
5-Pri 2 Year	27.4%	72.6%	63.5%	13.4%	14.4%	0.3%	3.0%	41.9%	58.1%	43.0%	20.9%	18.0%	0.4%	6.0%
6-Prop 2 Year	42.6%	57.4%	52.7%	17.0%	16.1%	0.8%	3.8%	29.1%	70.9%	37.6%	20.5%	26.2%	1.0%	3.8%
7-Pub < 2 Year	41.2%	58.8%	50.0%	29.3%	11.6%	3.2%	4.1%	33.1%	66.9%	66.0%	6.5%	22.1%	1.3%	1.4%
8-Priv < 2 Year	41.3%	58.7%	30.8%	42.9%	18.3%	0.1%	5.4%	49.9%	50.1%	14.1%	58.0%	22.6%	0.2%	4.0%
9-Prop < 2 Year	22.2%	77.8%	42.7%	24.7%	20.0%	0.6%	3.3%	27.0%	73.0%	28.1%	30.8%	26.9%	0.6%	2.8%

**2008 Demographic Distribution Below/Above 12% Threshold**

	Demographic Distribution Below 12%							Demographic Distribution Above 12%						
	Male	Female	White	Hispanic	Black	American Indian	Asian	Male	Female	White	Hispanic	Black	American Indian	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	43.1%	56.9%	59.2%	11.0%	11.5%	0.9%	6.2%	38.6%	61.4%	45.2%	18.6%	17.6%	1.0%	4.6%
School Type														
1-Public 4 Year	44.6%	55.4%	62.5%	9.7%	10.1%	0.9%	6.6%	42.8%	57.2%	45.3%	10.1%	32.6%	0.7%	4.9%
2-Pri 4 Year	42.4%	57.6%	60.8%	7.4%	9.4%	0.6%	5.6%	41.0%	59.0%	6.7%	61.5%	28.2%	0.4%	0.4%
3-Prop 4 Year	40.7%	59.3%	40.6%	9.9%	22.0%	0.7%	3.7%	31.0%	69.0%	36.9%	9.0%	19.7%	0.9%	2.4%
4-Public 2 Year	42.8%	57.2%	56.2%	14.8%	13.3%	1.1%	6.6%	42.0%	58.0%	53.2%	18.6%	12.9%	1.2%	5.8%
5-Pri 2 Year	31.1%	68.9%	61.6%	13.0%	15.5%	0.3%	4.2%	37.0%	63.0%	33.7%	29.4%	16.0%	0.2%	3.1%
6-Prop 2 Year	36.6%	63.4%	47.4%	18.5%	19.2%	1.0%	4.2%	28.8%	71.2%	34.3%	20.7%	29.3%	0.9%	3.1%
7-Pub < 2 Year	40.4%	59.6%	51.9%	26.1%	13.3%	2.9%	3.7%	21.9%	78.1%	75.1%	6.3%	14.2%	0.8%	1.8%
8-Priv < 2 Year	39.6%	60.4%	30.9%	43.5%	17.9%	0.1%	5.1%	53.6%	46.4%	11.7%	59.0%	23.7%	0.2%	4.2%
9-Prop < 2 Year	22.5%	77.5%	43.2%	23.9%	20.8%	0.6%	3.3%	28.4%	71.6%	22.3%	33.9%	28.4%	0.5%	2.6%

2007 Demographic Distribution Below/Above 8% Threshold

	Demographic Distribution Below 8%							Demographic Distribution Above 8%						
	Male	Female	White	Hispanic	Black	American Indian	Asian	Male	Female	White	Hispanic	Black	American Indian	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	43.3%	56.7%	62.0%	9.4%	9.9%	0.9%	6.4%	40.7%	59.3%	50.9%	16.4%	16.5%	1.0%	5.2%
School Type														
1-Public 4 Year	44.9%	55.1%	64.5%	9.3%	8.3%	0.9%	6.9%	39.8%	60.2%	48.3%	9.9%	31.9%	1.7%	2.5%
2-Pri 4 Year	42.4%	57.6%	62.3%	7.1%	8.7%	0.6%	5.6%	40.5%	59.5%	24.5%	35.6%	29.5%	0.4%	1.8%
3-Prop 4 Year	37.2%	62.8%	43.2%	5.8%	20.7%	0.7%	3.6%	35.9%	64.1%	36.5%	10.9%	18.7%	0.8%	2.7%
4-Public 2 Year	42.0%	58.0%	57.6%	12.6%	14.8%	1.4%	6.6%	42.4%	57.6%	56.2%	16.4%	12.0%	1.0%	6.4%
5-Pri 2 Year	29.6%	70.4%	58.5%	16.2%	13.5%	0.4%	3.8%	41.2%	58.8%	62.2%	7.1%	20.4%	0.7%	3.0%
6-Prop 2 Year	49.2%	50.8%	55.3%	14.1%	13.9%	0.8%	4.6%	30.6%	69.4%	40.3%	21.8%	25.3%	1.0%	3.3%
7-Pub < 2 Year	38.1%	61.9%	68.3%	9.4%	13.0%	3.8%	2.8%	35.4%	64.6%	68.3%	7.0%	16.7%	3.1%	1.5%
8-Priv < 2 Year	24.9%	75.1%	42.3%	26.4%	20.5%	0.2%	5.4%	53.5%	46.5%	8.2%	58.0%	15.5%	0.2%	5.4%
9-Prop < 2 Year	18.0%	82.0%	47.2%	25.3%	18.1%	0.7%	4.1%	29.1%	70.9%	29.4%	31.8%	25.5%	0.7%	2.9%

2007 Demographic Distribution Below/Above 12% Threshold

	Demographic Distribution Below 12%							Demographic Distribution Above 12%						
	Male	Female	White	Hispanic	Black	American Indian	Asian	Male	Female	White	Hispanic	Black	American Indian	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	42.7%	57.3%	59.8%	10.4%	11.5%	0.9%	6.2%	41.0%	59.0%	48.1%	21.2%	16.6%	1.0%	4.6%
School Type														
1-Public 4 Year	44.4%	55.6%	63.3%	9.4%	10.0%	1.0%	6.5%	42.2%	57.8%	43.2%	8.0%	36.1%	0.6%	5.2%
2-Pri 4 Year	42.3%	57.7%	61.4%	7.6%	9.4%	0.6%	5.5%	41.5%	58.5%	4.6%	60.6%	32.3%	0.1%	0.5%
3-Prop 4 Year	37.2%	62.8%	40.0%	8.4%	20.0%	0.8%	3.1%	29.0%	71.0%	27.8%	16.1%	14.3%	0.5%	1.8%
4-Public 2 Year	42.1%	57.9%	57.4%	13.6%	13.2%	1.1%	6.9%	42.7%	57.3%	54.6%	19.5%	12.4%	1.1%	5.2%
5-Pri 2 Year	31.1%	68.9%	59.4%	14.9%	14.4%	0.4%	3.7%	43.3%	56.7%	60.2%	6.2%	21.5%	1.0%	2.8%
6-Prop 2 Year	39.0%	61.0%	50.6%	15.6%	18.1%	1.1%	4.5%	33.5%	66.5%	36.8%	25.2%	26.9%	0.7%	2.7%
7-Pub < 2 Year	37.2%	62.8%	69.9%	8.7%	12.8%	3.5%	2.6%	38.9%	61.1%	59.2%	9.0%	21.1%	4.5%	1.6%
8-Priv < 2 Year	38.2%	61.8%	31.5%	41.3%	16.5%	0.2%	6.2%	45.7%	54.3%	8.8%	49.1%	19.7%	0.2%	4.1%
9-Prop < 2 Year	21.0%	79.0%	44.3%	24.7%	19.8%	0.7%	3.8%	31.1%	68.9%	23.5%	36.5%	27.2%	0.7%	2.6%

**APPENDIX FIGURE 7: SUPPLEMENTAL DATA FROM PART FOUR –  
ODDS RATIOS FOR THRESHOLD CDRS (2007 – 2008)<sup>213</sup>**

**2008 Distribution of race/gender group**

Distribution	Odds Ratio above/below threshold 8%							Odds Ratio above/below threshold 12%						
	Male	Female	White	Hispanic	Black	Native	Asian	Male	Female	White	Hispanic	Black	Native	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	0.9	1.1	0.7	1.8	1.7	1.3	0.8	0.8	1.2	0.6	1.8	1.6	1.2	0.7
sec														
1-Public 4 Year	0.8	1.2	0.6	1.1	4.6	1.7	0.4	0.9	1.1	0.5	1.0	4.3	0.7	0.7
2-Pri 4 Year	1.0	1.0	0.2	8.0	3.7	0.7	0.2	0.9	1.1	0.0	20.1	3.8	0.7	0.1
3-Prop 4 Year	0.8	1.2	0.9	1.7	0.9	1.3	0.8	0.7	1.5	0.9	0.9	0.9	1.2	0.6
4-Public 2 Year	1.0	1.0	1.0	1.3	0.7	0.9	1.0	1.0	1.0	0.9	1.3	1.0	1.2	0.9
5-Pri 2 Year	1.9	0.5	0.4	1.7	1.3	1.2	2.0	1.3	0.8	0.3	2.8	1.0	0.6	0.7
6-Prop 2 Year	0.6	1.8	0.5	1.3	1.9	1.3	1.0	0.7	1.4	0.6	1.2	1.7	0.9	0.7
7-Pub < 2 Year	0.7	1.4	1.9	0.2	2.2	0.4	0.3	0.4	2.4	2.8	0.2	1.1	0.3	0.5
8-Priv < 2 Year	1.4	0.7	0.4	1.8	1.3	2.5	0.7	1.8	0.6	0.3	1.9	1.4	2.4	0.8
9-Prop < 2 Year	1.3	0.8	0.5	1.4	1.5	0.9	0.8	1.4	0.7	0.4	1.6	1.5	0.8	0.8

**2007 Distribution of race/gender group**

Distribution	Odds Ratio above/below threshold 8%							Odds Ratio above/below threshold 12%						
	Male	Female	White	Hispanic	Black	Native	Asian	Male	Female	White	Hispanic	Black	Native	Asian
	%	%	%	%	%	%	%	%	%	%	%	%	%	%
All	0.9	1.1	0.6	1.9	1.8	1.2	0.8	0.9	1.1	0.6	2.3	1.5	1.1	0.7
sec														
1-Public 4 Year	0.8	1.2	0.5	1.1	5.2	2.0	0.3	0.9	1.1	0.4	0.8	5.1	0.7	0.8
2-Pri 4 Year	0.9	1.1	0.2	7.2	4.4	0.8	0.3	1.0	1.0	0.0	18.8	4.6	0.2	0.1
3-Prop 4 Year	0.9	1.1	0.8	2.0	0.9	1.2	0.7	0.7	1.4	0.6	2.1	0.7	0.7	0.6
4-Public 2 Year	1.0	1.0	0.9	1.4	0.8	0.7	1.0	1.0	1.0	0.9	1.5	0.9	1.0	0.7
5-Pri 2 Year	1.7	0.6	1.2	0.4	1.6	1.6	0.8	1.7	0.6	1.0	0.4	1.6	2.4	0.8
6-Prop 2 Year	0.5	2.2	0.5	1.7	2.1	1.2	0.7	0.8	1.3	0.6	1.8	1.7	0.6	0.6
7-Pub < 2 Year	0.9	1.1	1.0	0.7	1.3	0.8	0.5	1.1	0.9	0.6	1.0	1.8	1.3	0.6
8-Priv < 2 Year	3.5	0.3	0.1	3.8	0.7	0.9	1.0	1.4	0.7	0.2	1.4	1.2	1.1	0.7
9-Prop < 2 Year	1.9	0.5	0.5	1.4	1.5	1.0	0.7	1.7	0.6	0.4	1.8	1.5	1.1	0.7

# Student Loan Glossary

<b>ANTI-INDUCEMENT RULES</b>	Generally refers to provisions in the Higher Education Act that prohibit lending arrangements where a student lender provides benefits to a school in exchange for considerations such as referral of increased loan volumes.
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<b>ASSET-BACKED SECURITIZATION</b>	The creation of a financial instrument by combining a pool of loans (assets) and then selling different tiers of securities to investors who are repaid out of the receipts from the financial assets. In general, a sponsor of the transaction sells loans or other assets to a bankruptcy-remote trust. The trust is technically the “issuer” of asset backed securities, although the sponsor is sometimes referred to by that term. The “investors” are the parties who purchase the securities (typically bonds or notes) issued by the trust. The process can encompass any type of financial asset and promotes liquidity in the marketplace. By combining loans into one large pool, an issuer can divide the cash flows from the large pool of assets into smaller pieces and sell those smaller pieces to investors. Securitization creates liquidity by enabling smaller investors to be able to purchase cash flows from portions of larger pools. Assets typically placed into ABS securities include auto loans and leases, credit card receivables, and both federal and private student loans. The structuring of cash flows through securitization, i.e. the different terms governing how much and when cash is paid out to the investors, allows the market to separate different forms of risk (for example, interest rate and credit risk) associated with the same pool of loans.
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<b>BPS OR BASIS POINTS</b>	One basis point is equal to one one-hundredth of one percent or 0.01%
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<b>COHORT DEFAULT RATE</b>	Measured by the Department of Education: the percentage of a school's borrowers who enter repayment on certain Federal Family Education Loan (FFEL) Program or William D. Ford Federal Direct Loan (Direct Loan) Program loans during a particular federal fiscal year (FY), October 1 to September 30, and default or meet other specified conditions prior to the end of the next fiscal year.
<b>COLLATERALIZATION RATIO</b>	With regard to an Asset-Backed Securitization, collateralization ratio is the ratio of trust assets (loans sold to the trust plus cash accounts) to trust liabilities (notes sold by the trust). May also be called a parity ratio.
<b>DEPOSITORY INSTITUTION LENDERS</b>	Private student lenders who hold a charter to accept deposits (i.e. banks and credit unions).
<b>DTC OR DIRECT-TO-CONSUMER</b>	Unlike school-certified private student loans, direct-to-consumer student loans are typically not certified by a school's financial aid office. In the certification process, a school's financial aid office will communicate with a lender (usually electronically) to verify a student's enrollment status at the school as well as financial need levels.
<b>EXCESS SPREAD</b>	With regard to an Asset-Backed Securitization, the excess spread refers to the remaining income after all required expenses and other payables, including required interest and principal payments, have been satisfied; it is the "net interest income" of the structure.
<b>FAIR LENDING</b>	Federal law, such as the Equal Credit Opportunity Act, prohibits discrimination in credit transactions based on factors such as race or color, religion, national origin, sex, marital status, and age.
<b>FEDERAL STUDENT LOANS</b>	Money borrowed directly from the U.S. Department of Education to help cover the cost of higher education at a participating post-secondary institution. Requires the completion of a FAFSA or Free Application for Federal Student Aid. The Department of Education is now the sole lender for the Direct Stafford Loans and Direct PLUS Loan (Direct Loan) programs. Please see <a href="http://studentaid.ed.gov/">http://studentaid.ed.gov/</a>

<b>FICO</b>	Stands for Fair Isaac Corporation, a purveyor of credit scoring algorithms and methodologies. Many consumers refer, correctly or incorrectly, to their credit score as a FICO score. FICO is only one subset of proprietary credit scores. Lenders use credit scores to assess an applicant's credit risk and whether to extend credit. Credit scores take into account factors such as payment history, indebtedness level, types of credit used, length of credit history, and number of new credit inquiries to assess credit risk. In general, FICO scores range between 300 and 850.
<b>FIXED-RATE</b>	Since 2006, all federal student loans have carried a fixed interest rate. Some private student loans carry a fixed interest rate as well. The interest rate is set at the time of origination and does not change throughout the life of a loan.
<b>FORBEARANCE</b>	A temporary cessation of payments granted by a lender or servicer typically when a borrower encounters temporary reduction in his ability to repay a student loan
<b>FULL DEFERMENT</b>	Refers to a schedule of payments under which a borrower does not make payment toward principal and/or interest while in a qualifying period. While student loan borrowers are in school, their loans are typically deferred, meaning that payments of both principal and interest are not due to begin until the borrower separates (transfer, graduate, drop-out, or otherwise leave) from school. After a deferral period ends, there is typically a grace period of six (6) months before payments are due. While terms and conditions vary for private student loans, the Department of Education (ED) has published a list of the reasons qualifying for a deferment. <a href="http://studentaid.ed.gov/">http://studentaid.ed.gov/</a>
<b>INCOME-BASED REPAYMENT</b>	An available federal student loan repayment program that allows borrowers to limit the amount repaid each month based on the borrower's income. Borrowers must qualify based on factors such as income, family size, and state of residence. The Department of Education has more information about IBR <a href="http://studentaid.ed.gov/">http://studentaid.ed.gov/</a>
<b>LIBOR</b>	London Interbank Offered Rate; the interest rate at which banks can borrow funds from other banks in the London interbank market. LIBOR is fixed on a daily basis by the British Bankers' Association. There are different LIBOR rates for different terms. Variable-rate PSLs often use 30 day or 90 day LIBOR as an index to reset rates.
<b>NON-BANK ORIGINATORS</b>	Some private student lenders operated and originated loans without a bank charter. For example, a lender could purchase loans from a bank who originated loans under a forward purchase contract with the non-bank lender. The non-bank lender may have prescribed the types of loans that it

was willing to purchase or in some cases may have helped set the credit policy to determine which loans a bank originator would make for sale. See also Depository Institution Lenders.

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**ORIGINATION FEES**

A fee charged when a loan is made to a borrower. Origination fees are typically charged to cover a lender's cost of processing an application and disbursing funds to a customer. Origination fees are usually included in the loan amount.

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**ORIGINATION VINTAGE**

The aggregate group of loans granted to borrowers in a given period (for the purposes of this Report, usually a calendar or academic year).

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**OVERCOLLATERALIZATION**

With regard to an Asset-Backed Securitization, overcollateralization refers to the amount by which the assets (the collateral) pledged by a securitization trust exceed the principal value of the liabilities issued. The additional collateral represents additional security for the note holders and typically functions as a credit enhancing feature.

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**PRIVATE STUDENT LOANS**

Any loans made for post-secondary education that are not federal student loans. The term excludes 12 month payment plans that do not charge interest on short-term balances due to schools. Unlike federal student loans, the interest rate and fees paid on a private student loan are based on a borrower's and/or co-signer's current creditworthiness, as tested at the time of application.

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**SECONDARY MARKET**

A market where investors can purchase or trade securities or assets

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**SLABS**

Student Loan Asset-Backed Security; See Asset-Backed Securitization

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**TALF OR TERM ASSET-BACKED SECURITIES LOAN FACILITY**

A program established by the Federal Reserve in November 2008 to assist in the issuance of asset-backed securities as investor liquidity in the ABS market had waned. The program ended in 2010.

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**TAX-ADVANTAGED BOND FUNDING**

Some non-profit, state-affiliated private student lenders issue either revenue bonds or asset-backed securities supported by the cash flows from private student loans made by the lender. In certain circumstances, depending on the status of the issuer and the investor, the interest paid on bonds issued by state-affiliated entities is exempt from federal and/or state income taxation.

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**TERI-GUARANTEED SERVICING GUIDELINES**

TERI stands for The Education Resources Institute, a Massachusetts non-profit corporation that, prior to its bankruptcy in 2008, provided loan default insurance or guarantees covering private student loans that were originated according to TERI's guidelines and policies. See note [20].

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**UNDERWRITING (CREDIT) STANDARDS**

Guidelines established to ensure that safe and sound loans are issued and maintained. Credit underwriting standards, sometimes called a credit policy, typically set benchmarks for how much may be lent to a person, the terms, conditions and purposes of a loan, and what interest rate will be charged. For consumer credit, lenders often consider credit score, credit reports, income, employment, and the assets of a debtor.

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**VARIABLE-RATE**

Many private student loans have variable interest rates, meaning the interest rate can change from time to time over the life of a loan. Variable interest rate loans are tied to an index, such as LIBOR or the Prime rate. When the index changes (up or down) the underlying interest rate of a loan changes. Rates may reset monthly, quarterly or even semi-annually. A margin is added to the current index value to determine the total interest rate for the loan. The margin is set at the time of origination and varies based on the credit worthiness of a borrower. This variation in margin value is one way that a creditor might establish "risk-based" pricing.

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# References and Notes

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<sup>1</sup> As used in this Report, the term “private student loan” is defined by reference to section 140 of the Truth in Lending Act (15 USC § 1650). That term excludes short term credit advanced by schools (90 days or less) and payment plans of 12 months or less that do not involve periodic interest charges. This Report does not cover these common short-term financing methods.

<sup>2</sup> Section 1077 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

<sup>3</sup> The CFPB and the Department of Education would like to express their gratitude to the 9 participating lenders for their willingness to participate in this data collection effort, not only for the meaningful information that they shared voluntarily, but also because of the compressed time-frame over which the parameters of the data request were defined and agreed to and the promptness of the data delivery. The participating lenders included: RBS Citizens N.A., Discover Financial Services, The First Marblehead Corporation, JPMorgan Chase Bank, N.A., PNC Bank, N.A., Sallie Mae, Inc., SunTrust Banks, Inc., U.S. Bank National Association, and Wells Fargo Bank, N.A.. The information was provided under a non-disclosure agreement and is protected under various federal laws as proprietary and confidential business information.

<sup>4</sup> We note that credit unions typically participate through joint platforms, such as Fynanz (cuStudentLoans), Credit Union Student Choice. These loans are held on credit union balance sheets and are playing a larger part in the PSL marketplace as some large banks have recently reduced their involvement in the market.

<sup>5</sup> The College Board, *Trends in Student Aid 2011*, p. 10; State Lender Data

<sup>6</sup> Federal loans made up 39% of student aid received by undergraduates and 69% of total graduate student aid. Federal grants constituted 27% of grants on which undergraduates

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relied and 2% of graduate student aid. Tax credits added another material portion of aid. Thus, the federal government provides more than 2/3 of the direct aid to all post-secondary students. See The College Board, *Trends in Student Aid 2011*, p. 11.

<sup>7</sup> The College Board, *Trends in Student Aid 2011*, p. 13.

<sup>8</sup> Parents may obtain a federal parental PLUS direct loan without completing a FAFSA.

<sup>9</sup> Sallie Mae and Ipsos Public Affairs, *How America Pays for College 2011*, p. 6 “This is an increase of 8% over prior years, mostly amongst upper income students.”

<sup>10</sup> “Private education loans are designed to bridge the gap between family resources, scholarship and grants, federal loans and the cost of a college education.” Sallie Mae. Primer on Private Education Loans. Accessed on 12 Jun. 2012, available at [https://www1.salliemae.com/about/news\\_info/primer%20on%20private%20education%20loans.htm](https://www1.salliemae.com/about/news_info/primer%20on%20private%20education%20loans.htm)

“Students finance their postsecondary education by means of family contributions, federal loans, grants and work-study, state grants, institutional grants and loans and, sometimes, outside scholarships. When these sources of funding do not add up to the full amount needed, some students turn to private loans. Other students may not have a pressing financial need and may bypass need-based financial aid resources in favor of a private loan. Thus, paradoxically, for some individuals, private student loans are a resource of necessity, whereas for others they serve as a resource of convenience.” USA Funds, Guide to Student Loan Issues. Accessed on 12 Jun. 2012, available at <http://www.usafunds.org/Media/Reports%20and%20White%20Papers/GuideStudentLoanIssue.pdf>

<sup>11</sup> 34 C.F.R. §682.200(b)(i); 34 C.F.R. 673.5(d)). Recapture may in fact be rare, because a financial aid office that learned of overborrowing by a federal aid recipient likely would counsel the student to cancel the excess portion of the PSL. Most PSL lenders allow cancellation (partial prepayment) without interest or penalty for a period of time after disbursement. Even if federal aid recapture is purely a theoretical risk, the effect of borrowing substantially more than is needed for a particular degree can be quite severe, as demonstrated in the default rates for DTC loans (see text at Note 51).

<sup>12</sup> 20 USC §1078-8 (d)(3)(B).

<sup>13</sup> 20 USC §1078-8.

<sup>14</sup> Federal loan limitations have changed frequently in the past decade, as set forth in the following table:

DATES	ANNUAL LIMIT	LOAN PROGRAM	AUTHORIZING STATUTE
January 1, 1987 to June 30, 2007	\$2,625- First-Year Borrowers	Dependent Undergraduate Subsidized Stafford	1986 HEA Amendments (P.L. 99-498)
October 1, 1993 to June 30, 2007	\$3,500- Second Year \$5,500- Third or more	Dependent Undergraduate Subsidized Stafford	1992 HEA Amendments (P.L. 102-325)
October 1, 1993 to Present	COA minus EFA	Federal PLUS (Parent)	
July 1, 1994 to June 30, 2007	\$6,625- First Year \$7,500- Second Year \$10,500- Third or more	Independent Undergraduate Total (Sub. & Unsub.) Stafford	
	\$8,500- Subsidized Grad	Graduate Subsidized Stafford	
July 1, 1994 to June 30, 2012	\$18,500-Total Grad	Graduate Total Stafford	
July 1, 2007 through Present	\$3,500- First Year \$4,500- Second Year \$5,500- Third or more	Dependent Undergraduate Subsidized Stafford	Higher Education Reconciliation Act of 2005 (P.L. 109-171)
	COA minus EFA	Graduate PLUS Loans	
July 1, 2007 through June 30, 2012	\$8,500 Subsidized Grad \$20,500- Total Grad	Graduate Stafford	
July 1, 2007 through June 30, 2008	\$7,500- First Year \$8,500- Second Year \$10,500- Third or more	Independent Undergraduate Total Stafford	
July 1, 2008 through Present	\$9,500- First Year \$10,500- Second Year \$12,500- Third or more	Independent Undergraduate Total Stafford	Ensuring Continued Access to Student Loans Act of 2008 (P.L. 110-227)
July 1, 2012 through Present	N.A.- Subsidized Grad \$20,500- Unsub Grad	Unsubsidized Graduate PLUS Loan	Budget Control Act of 2011 (P.L. 112-25)

<sup>15</sup> 20 U.S.C. § 1078(b), (c). The guarantees were issued by state guaranty agencies, but reinsured by the Department.

<sup>16</sup> 20 USC §1087-1.

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<sup>17</sup> 20 USC §1085(d)(3).

<sup>18</sup> The situation changed with the enactment of the Higher Education Opportunity Act of 2008. That Act imposed code of conduct requirements on schools that prohibit cozy relationships with lenders, as well as imposing stringent requirements on any school who wishes to recommend a private lender. See section 487(e)(5) of the Higher Education Act (20 USC § 1094(e)(5)). Disclosure and process rules for adopting a “preferred lender arrangement” are now required under sections 152 and 153 of the Act (20 USC § 1019a & 1019b). Technically speaking, PSLs and FFELP referrals could never be explicitly tied in together. The HEOA amendments imposed procedures and disclosures to assure that implied quid pro quo relationships are prohibited.

<sup>19</sup> The ELM Resources platform, originally created by a consortium of lenders and schools, supported both Stafford and PSLs. [www.elmresources.com/ourstory](http://www.elmresources.com/ourstory)

<sup>20</sup> The PSL industry even generated its own private version of the federal loan guaranty, the non-profit private student loan guaranty company. For example, in 1985 the Massachusetts loan guaranty agency, now known as American Student Assistance, and several Massachusetts schools, formed a non-profit known as The Education Resources Institute, Inc. (“TERI”). TERI offered to provide private credit enhancement to banks that would make loans to students to attend approved schools. TERI dictated the underwriting criteria and eventually went into the loan origination business for loans it guaranteed. In its heyday, TERI guaranteed over \$16 billion in PSLs. *TERI Form 1099* (June 30, 2007). TERI filed a petition under Chapter 11 of the U.S. Bankruptcy Code in April 2008 and has since returned to its original mission of providing college access counseling.

<sup>21</sup> PLUS Parent loans have obvious and significant differences as compared to Stafford loans. PLUS loans are loans to parents, not students. They do not require a FAFSA. They require evidence of creditworthiness. They do not have repayment modification rights.

<sup>22</sup> 20 U.S.C. § 1078(b)(1)(M), 1078-8(e).

<sup>23</sup> There are minor proxies for ability to repay. The student cannot have an unresolved defaulted student loan, 20 U.S.C. §1091(a)(3). If a school’s “cohort default rate,” meaning the rate at which students in each group going into repayment on Stafford loans default within the first two years, exceeds statutory levels, the school will not be able to participate in Title IV. The threshold is very high at 25% average default over 3 successive years and 40% in any one year. The measurement will soon change to three-year default rate and the percentage thresholds will also change. 20 U.S.C. §1085(a)(2)

<sup>24</sup> Sample Lender qualitative responses.



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<sup>25</sup> The exceptions to this statement are rates offered by state-affiliated lenders, who offer a single, fixed rate. These lenders are discussed at the end of Part One.

<sup>26</sup> The 3.4% fixed rate is limited to one lender and varies greatly from the best rate for all others. It may reflect pricing based on a larger banking relationship with the co-signer.

<sup>27</sup> 20 USC § 1078-6(a), 1078-3(a).

<sup>28</sup> 20 USC § 1078-6(a)(1)(C).

<sup>29</sup> Sample Lender qualitative data.

<sup>30</sup> Part Three, TILA discussion.

<sup>31</sup> Note that 2005 initial rates reflect pricing that is generally lower than that offered today, in terms of the margins used to compute variable rates.

<sup>32</sup> The College Board, *Trends in Student Aid 2011*.

<sup>33</sup> Most of the lenders in the sample group use deposits and sources of funds typical for depository institutions to fund loans. Sallie Mae reports that it remains an active participant in the securitization market.

<sup>34</sup> Collateralization Ratio - With regard to an Asset-Backed Securitization, collateralization ratio is the ratio of trust assets (loans sold to the trust and other cash accounts) to trust liabilities (notes sold by the trust). May also be called a Parity Ratio, see Glossary.

<sup>35</sup> One rating agency explained in 2006: "Although most PSL ABS transactions have a parity ratio of 100% at closing, some transactions may have less. This situation can occur when securitization proceeds are used to cover transaction costs or when the loan collateral is acquired at a premium. A transaction parity ratio of less than 100% at closing is permitted as parity ratios or overcollateralization can be built up through: (1) excess spread, which typically is high for PSL collateral (see Excess Spread section), and (2) the inclusion of a "lock out" period for subordinate note principal payments (see Step-Down Date section for further details)." Available at <http://www.dbrs.com/research/207890/rating-u-s-private-student-loan-transactions.pdf>

To the extent a trust is undercollateralized, an issuer may be able to extract cash from the transaction immediately. The following table illustrates one issuer's use of this technique. To the extent net bond proceeds exceed loans purchased and pledged the issuer can take out cash. Additional credit enhancement features include features such as a loan level guarantee provided by a non-profit (e.g. - TERI, see Note 20) or bond-level or portfolio wrap insurance (supplied by firms like MBIA, Ambac, Assured Guaranty). Credit

enhancement allowed issuers to execute deals that varied in their levels of undercollateralization as of the time of issuance. For example, the parity ratio at issuance for National Collegiate Student Loan Trust 2007-4 was 98.3%, meaning that the assets pledged to the trust estate were less than the amount of notes issued by the trust estate or the trust was undercollateralized by 1.7%. Because of the deferred payment nature of a large percentage of PSL's, this trust estate required a \$351 million reserve account which was essentially funds borrowed by the issuance of notes to be able to pay interest on the notes while the underlying PSL's were not generating sufficient cash flow. However, PSL's accrue interest while in deferment, so parity ratios would continue to move towards overcollateralization fairly quickly.

<b>NCSLT Issuance</b>	<b>Amount of Bonds Issued</b>	<b>Loans pledged to trust</b>	<b>Parity Ratio at Issue</b>	<b>Loans Acquired to Notes Issued</b>
2004-1	\$715,100,000	\$572,261,755	98.3%	80.0%
2005-1	\$951,500,000	\$715,255,787	98.7%	75.2%
2006-1	\$900,697,000	\$748,421,240	98.5%	83.1%
2007-1	\$1,125,300,000	\$780,178,586	95.6%	69.3%
Source: National Collegiate Student Loan Trust Prospectus Supplements				

<sup>36</sup> Theoretically, the rating agencies who evaluated SLABS would have served to police quality issues and align the incentives of investors and issuers. That alignment appears, in retrospect, to have been imprecise.

<sup>37</sup> During the week of July 10, 2007, S&P, Moody's, and Fitch announced a series of downgrades on approximately \$5B in subprime MBS, and placed a series of CDO tranches on negative credit watch. *Report of Financial Crisis Inquiry Commission* ("FCICR"), page 242 available at <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>. This, along with rising defaults on the underlying subprime mortgages, triggered the closing of the ABCP market in August 2007. *Report of Financial Crisis Inquiry Commission*, page 251-2. These factors combined to close the ABS markets after July of 2007, as seen in Figure 5.

<sup>38</sup> The College Board, *Trends in Student Aid 2011*, pg. 10

<sup>39</sup> FCICR, pg 27 - 28.

<sup>40</sup> Sources:

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Moody's Investors Service "2004 Review and 2005 Outlook: Student Loan-Backed Securities Another Record Breaking Year" January 11, 2005. Page 3

Moody's Investors Service 2005 Review and 2006 Outlook: U.S. Student Loan-Backed Securities" January 16, 2006. Page 5.

Moody's Investors Service 2005 Review and 2006 Outlook: U.S. Student Loan-Backed Securities" January 16, 2006. Page 5.

Moody's Investors Service 2009 Review and 2010 Outlook: U.S. Student Loan-Backed Securities" January 28, 2010. Page 3.

Moody's Investor's Service "Private Student Loan ABS: 2011 Outlook and 2010 Review" December 7, 2010, Page 8

Moody's Investors Service "US Private Student Loan Securitizations:2012 Outlook" December 14<sup>th</sup>, 2011, Page 1.

<sup>41</sup> The Term Asset Backed Securities Loan Facility ("TALF") was created by the Federal Reserve in November 2008 to support the provision of consumer credit by providing liquidity to the asset backed securities market. The red shaded transaction volume in Figure 5 is government-assisted.

<sup>42</sup> Sample Lender Data - qualitative responses.

<sup>43</sup> Sample Lender Data - qualitative responses.

<sup>44</sup> Throughout the sample period, all loans for medical and legal programs were school certified. The proportion of undergraduate educational loans that were school certified increased from 27.8% in 2008 to 80.1% in 2009. Similarly, the proportion of graduate loans that were school certified increased from 26.3% in 2008 to 92.9% in 2009.

<sup>45</sup> Please note that total cost of attendance includes tuition and fees, room and board, books, and transportation and therefore exceeds the cost of tuition and fees alone. Additionally, considering that our Sample Lender data shows a 40% share of DTC in 2005, it is probable that the trend toward DTC, non-school certified, PSL lending was already well underway by the time our sample period started. Also note that because borrowers cannot be linked across lenders in the loan-level data these values represent within-lender loan amounts relative to tuition and fees and do not account for amounts individuals borrowed in an academic year across multiple lenders. Therefore, the amounts used in the computations may actually understate the ratio of loan amounts to costs.

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<sup>46</sup> Graduate students not at professional schools experienced a change in school certification level similar to undergraduates, but graduate students did not show a similar pattern of change in ratio of loan amounts to tuition and fees. The differences may be attributable to materially higher limits on graduate Stafford loans and, later in the period, Grad PLUS loans. Please see table at Note 14.

<sup>47</sup> The College Board, *Trends in Student Aid 2005 - 2011*

<sup>48</sup> Many lenders would base the FICO decision on the highest of available FICOs where multiple applicants had FICO scores. Within the Sample Lender loan level data, 95.9% of all educational loans considered at least one FICO score in the underwriting process.

<sup>49</sup> When the Federal Reserve created the TALF program to encourage the return of ABS as a funding vehicle, the private student loan ABS market rebounded in 2009 with \$10.3 billion in total issuance (54% of which was attributable to Sallie Mae, 19% to Student Loan Corporation and the remainder to a variety of state agencies and non-profits). Sallie Mae and Student Loan Corporation completed \$7.4 billion of this issuance in 5 TALF-eligible transactions. Sallie Mae accounted for 4 deals for with a total value of \$6 billion and Student Loan Corporation accounted for 1 deal worth \$1.4 billion. In 2010, dollar volumes fell as issuers only sold \$7.6B in ABS backed by private student loans. TALF-eligible volumes were only \$2.2 billion in 2010. TALF ended in June 2010.

<sup>50</sup> The reasons involve both accounting rules and transaction economics:

On the accounting side, Sallie Mae reported in its 2011 Form 10-K, p. F-9, "On January 1, 2010, we adopted the new consolidation accounting guidance. Under the new consolidation accounting guidance, if an entity has a variable interest in a VIE and that entity is determined to be the primary beneficiary of the VIE then that entity will consolidate the VIE. As it relates to our securitized assets, we are the servicer of the securitized assets and own the Residual Interest of the securitization trusts. As a result, we are the primary beneficiary of our securitization trusts and consolidated those trusts that were previously off-balance sheet at their historical cost basis on January 1, 2010. The historical cost basis is the basis that would exist if these securitization trusts had remained on-balance sheet since they settled. The new guidance did not change the accounting of any other VIEs in which we had a variable interest as of January 1, 2010." Effective 2010, FASB guidance on securitization trusts generally eliminated so-called "gain-on-sale" accounting treatment of securitizations and mandated consolidation of securitization trusts. This eliminated securitization as a source of GAAP profitability and hence capital for lenders.

On the structure side, the transaction economics of issuers have shifted over time as the structural components of private SLABS transactions have been dictated by credit rating agency stress cases and investors. This change is evidenced by the percentage of initial

overcollateralization of the following select Sallie Mae private SLABS deals from 2005 to 2012. During the 2005-2007 timeframe, it was common for Sallie Mae's private SLABS trusts to require very little asset value to be contributed in excess of the liabilities (notes) issued by the trust estate. This meant that Sallie Mae could sell loans to a trust for almost 100% of its funding cost, and recover the balance in subsequent trust payments very quickly. This has changed significantly after the credit crisis. For example, post-TALF transactions have required almost 30% more assets than liabilities for issuance. For every \$100 in loans sold to a trust, Sallie Mae initially receives \$70. See Note 35 for NCLST issuance metrics.

<b>SLM ABS Transaction</b>	<b>Overcollateralization at time of Issuance</b>
2005-A	0.5%
2006-A	0.5%
2007-A	0.5%
2010-A	31.7%
2011-A	20.7%
2012-A	27.0%
2012-B	25.9%
Source: SLM Private Credit Student Loan Trust Pre-Sale Reports via Moody's Investors Service (note: no reports for 2008-2009)	

<sup>51</sup> Moody's Investors Service noted the expected difference in the credit performance of these loans in their report *Direct-To-Consumer Student Loans: Higher Risk* (August 11, 2009) Moody's states, "DTC loans typically do not have the safeguards inherent in school channel loans that mitigate the risks borrowed funds will not be used for education or that students will take on excessive or unnecessarily expensive debt." At that time Moody's estimated the expected lifetime default rate for First Marblehead DTC loans to be 2.9 times the rate for school channel loans. Indeed, at its 2012 ASF presentation, First Marblehead estimated that loans in its legacy portfolio in its best credit segment would default at a lifetime rate of 10.4% while its lowest credit quality loans (predominantly DTC) would default at a lifetime rate of 52.3%. See First Marblehead ASF 2012 Presentation (Jan. 25, 2012) available at [http://edg1.vcall.com/irwebsites/firstmarblehead/ASF\\_Investor%20Presentation\\_FINAL.pdf](http://edg1.vcall.com/irwebsites/firstmarblehead/ASF_Investor%20Presentation_FINAL.pdf). This worst class of loans makes up 47% of the total FMD securitization portfolio.

<sup>52</sup> For example, we reviewed ratings listings published by Moody's as of June 6, 2012 for one of the largest issuers. From the 78 bond classes issued between 2004 and 2007 under the National Collegiate Student Loan Trust label, only 19 retained an investment grade, and all had been downgraded.

<sup>53</sup> The mix of payment options used by borrowers has also shifted. In 2005, most loans were fully deferred, like federal Stafford loans. After the crisis, Sample Lenders reported

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incenting borrowers through pricing and underwriting to make some payments during school, either accrued interest or a nominal payment of as little as \$25. Although throughout the sample period the majority of educational loans are fully deferred, Appendix Figure 5 shows that the share of loans that require some payments during school increases over the sample period: for undergraduate loans in 2005, 2.6% of loans require partial principal and interest payments during enrollment. By 2011, this proportion had doubled to 5.2%. Also, while partial repayment did not exist for graduate and professional school in 2005, partial repayment loans are observed starting in 2006 for graduate loans, 2007 for medical loans, 2008 for certificate/continuing education loans (In contrast to other graduate and professional schools, partial repayments are not observed for law school loans).

<sup>54</sup> Sample Lender Data qualitative responses.

<sup>55</sup> For more information, see *Report of the U.S. Senate Committee on Health, Education, Labor, and Pensions (HELP)* (June 14, 2007), available at <http://www.eric.ed.gov/PDFS/ED497127.pdf>, the New York State Office of the Attorney General <http://www.ag.ny.gov/consumer-frauds/student-lending> and a letter from the Iowa Attorney General to the Governor, dated September 19, 2008, available at [http://www.state.ia.us/government/ag/latest\\_news/releases/oct\\_2008/9-25-08.pdf](http://www.state.ia.us/government/ag/latest_news/releases/oct_2008/9-25-08.pdf)

<sup>56</sup> Subsections 487(a)(27) and 487(h) impose both process and disclosure requirements. 20 USC § 1094(a)(27), (h). Subsection 152(a)(1)(A)(ii) requires the school to give the same loan application and solicitation disclosure that a lender must give to a prospective borrower. 20 USC § 1019a(a)(1)(A)(ii). The latter is highly complex and changes whenever the lender changes a program or a rate.

<sup>57</sup> In a recent survey, one third of financial aid administrators stated they had not looked at any information about PSLs in the last year. National Association of Student Financial Aid Administrators & Consumer Bankers Association *Private Education Loans and the Perspectives of Student Financial Aid Administrators: A 2012 Survey*.

<sup>58</sup> The key definition is in section 140 of the Truth-in-Lending Act, 15 USC §1650, which is incorporated by reference in section 151 (9) of the HEA, 20 USC §1019(9).

<sup>59</sup> See Part Three, TILA discussion.

### Private Student Loan Non-Profit ABS Issuance Volume (\$ in mm's)

	2006	2007	2008	2009	2010	2011	Total Issuance
Issuance	1.8	1.1	0.9	1.4	2.0	0.9	8.1

<sup>61</sup> See above.

<sup>62</sup> These are technically not the “private education loan” that is the topic of this Report. See Note 1.

<sup>63</sup> Sallie Mae, Form 10-K 2008 p. 8. “At the beginning of 2008, we announced the discontinuation of non-traditional lending.”

See also, Alejandro Lazo, *Sallie Mae Forecasts Surge in Defaults*, Washington Post (Jan 23, 2009) available at [http://www.washingtonpost.com/wp-dyn/content/article/2009/01/22/AR2009012203631\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2009/01/22/AR2009012203631_pf.html)

<sup>64</sup> Sample Lender qualitative responses.

<sup>65</sup> Charge-off rates on Sallie Mae’s “non-traditional” PSL portfolio range from 7.1% (with co-signer) to 11.6% (without co-signer) compared to traditional loss rates of 1.4% and 3.9%, respectively. Sallie Mae, *1<sup>st</sup> Quarter 2012 Earnings Presentation*, p. 18, available at <https://www1.salliemae.com/NR/rdonlyres/50F355EE-8FA7-49FA-AABF-D4A4B507A89C/16002/Q112EarningsPresentationvFinal.pdf>

<sup>66</sup> For example, Corinthian Colleges (COCO) reported on page 45 of its Form 10-K 2011 the creation of a \$450 million “discount loan” program under which the for-profit school provides credit support for the lender by rebating (or discounting) a portion of PSL loan proceeds back to the lender. COCO also reported it is liable to purchase PSLs that become 90 days past due.

<sup>67</sup> ITT reported such a program, dubbed PEAKS, in its Form 10-K 2011, pages 48 and 49.

<sup>68</sup> See Thomson StreetEvents. Final Transcript: COCO - Q4 2009 Corinthian Colleges Earnings Conference Call. August 25, 2009. Page 9.

<sup>69</sup> First professional degrees may be awarded in the following 10 fields: chiropractic (D.C. or D.C.M.), dentistry (D.D.S. or D.M.D.), law (L.L.B or J.D.), medicine (M.D.), optometry

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(O.D.), osteopathic medicine (D.O.), pharmacy, (Pharm.D.), podiatry (D.P.M., D.P., or Pod.D.), theology (M.Div., M.H.L., B.D., or Ordination), and veterinary medicine (D.V.M).

<sup>70</sup> See Tables 2 and 4.

<sup>71</sup> See Table 3.

<sup>72</sup> See Table 4, The proportion of students with loans who have a federal loan can be calculated by summing the proportions of students who have federal loans only and federal and non-federal loans and dividing by the proportion of students who have any type of loan (federal only, PSL only, and federal and PSL).

<sup>73</sup> See Table 9.

<sup>74</sup> See Figure 15.

<sup>75</sup> See Table 6.

<sup>76</sup> See Table 10.

<sup>77</sup> See Table 12.

<sup>78</sup> See Table 13.

<sup>79</sup> In the statistics reported in this section, federal loans include PLUS loans.

<sup>80</sup> See Table 4.

<sup>81</sup> Throughout this section, t-statistics to test the equality of means are calculated under the assumption that variances are not equal between groups, and is computed as follows:

$t = \frac{\bar{x} - \bar{y}}{\sqrt{s_x^2/n + s_y^2/m}}$  where  $\bar{x}, \bar{y}$  are the sample means and  $s_x^2/n, s_y^2/m$  are the corresponding sample variances. Degrees of freedom are calculated as  $v = \left\lfloor \frac{(s_x^2/n + s_y^2/m)^2}{(s_x^2/n)^2/(n-1) + (s_y^2/m)^2/(m-1)} \right\rfloor$ . (Larsen and Marx 2001).

<sup>82</sup> Larsen, Richard and Morris L. Marx. *An Introduction to Mathematical Statistics and Its Applications*. 3<sup>rd</sup> Edition. Upple Saddle River, NJ: Prentice Hall, 2001.

<sup>83</sup>  $t=29.9$ .

<sup>84</sup>  $t=5.8$ .

<sup>85</sup>  $t=3.0$ .



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<sup>86</sup>  $t=5.9$ .

<sup>87</sup>  $t=1.0$ .

<sup>88</sup> For students age 19-23:  $t=7.9$  for the test of equality of means with students age 18 or younger,  $t=7.3$  for the test of equality of means with students age 30-39,  $t=8.5$  for the test of equality of means with students age 40 or older. For students age 24-29, the analogous t-statistics are 5.1, 4.9, and 5.3.

<sup>89</sup> For students age 19-23:  $t=4.7$  for the test of equality of means with students age 18 or younger,  $t=2.2$  for the test of equality of means with students age 30-39,  $t=8.2$  for the test of equality of means with students age 40 or older. For students age 24-29, the analogous t-statistics are 4.2, 1.7, and 6.6. For a test of equality of means between students age 19-23 and students age 24-29,  $t=0.8$ .

<sup>90</sup> For African-American undergraduates,  $t=5.4$  for the test of equality of means with white students,  $t=6.4$  for the test of equality of means with Hispanic/Latino students,  $t=13.3$  for the test of equality of means with Asian students,  $t=5.3$  for the test of equality of means with students of other races.

<sup>91</sup> For Asian undergraduates,  $t=-13.0$  for the test of equality of means with white students,  $t=-13.2$  for the test of equality of means with African-American students,  $t=-7.6$  for the test of equality of means with Hispanic/Latino students,  $t=-6.2$  for the test of equality of means with other students.

<sup>92</sup>  $t=3.3$ .

<sup>93</sup>  $t=2.8$ .

<sup>94</sup>  $t=3.9$ .

<sup>95</sup>  $t=-13.5$ .

<sup>96</sup> For students whose parents' highest level of education is a post-graduate degree:  $t=-10.4$  for a test of equality of means with students whose parents' highest level of education is high school or less,  $t=-7.0$  for a test of equality of means with students whose parents' highest level of education is college attendance with no degree attained,  $t=-8.3$  for a test of equality of means with students whose parents highest level of education is an associate's degree or vocational training, and  $t=-5.4$  for a test of equality of means with students whose highest level of education is a bachelor's degree. For students whose parents' highest level of education is a bachelor's degree:  $t=-4.0$  for a test of equality of means with students whose parents' highest level of education is an associate's degree or vocational training,  $t=-3.1$  for a test of equality of means with students whose parents

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highest level of education is college attendance with no degree attained, and  $t=-4.3$  for a test of equality of means with students whose parents highest level of education is high school or less.

<sup>97</sup> We test for equality of means by pairwise comparison of means of groups.  $t=-1.3$  for the test of equality of means between students with whose parents have a high school degree or less with students whose parents attended college but have no degree,  $t=-1.0$  for the test of equality of means between students whose parents have a high school degree or less with students whose parents have an associate's degree or vocational training,  $t=1.57$  for a test of equality of means for students whose parents have a high school degree or less to those whose parents have a bachelor's degree,  $t=0.4$  for a test of equality of means between students whose parents have a high school education or less to those whose parents have post-graduate degrees. For students whose parents have attended college degree,  $t=0.3$  for a test of equality of means with students whose parents have an associate's degree or vocational training,  $t=0.3$  for a test of equality of means with students whose parents have bachelor's degrees, and  $t=0.9$  for a test of equality of means for students whose parents have post-graduate degrees. For students whose parents have associate's degrees or vocational training,  $t=0$  for a test of equality of means with students whose parents have bachelor's degrees and  $t=0.6$  for a test of equality of means for students whose parents have post-graduate degrees. For students whose parents have bachelor's degrees,  $t=0.8$  for a test of equality of means with students whose parents have bachelor's degrees.

<sup>98</sup> For students whose parents highest level of education is high school or less:  $t=1.2$  for the test of equality of means with the students whose parents highest level of education is college attendance with no degree, and  $t=-0.8$  for the test of equality of means with students whose highest level of education is an associate's degree or vocational training.

<sup>99</sup>  $t=-3.0$ .

<sup>100</sup>  $t=3.3$ .

<sup>101</sup>  $t=1.2$ .

<sup>102</sup> For students whose parents' highest level of education is a bachelor's degree:  $t=-4.3$  for a test of equality of means with students whose parents' highest level of education is high school or less,  $t=-3.1$  for a test of equality of means with students whose parents' highest level of education is college attendance with no degree attained, and  $t=-4.0$  for a test of equality of means with students whose parents highest level of education is an associate's degree or vocational training.

<sup>103</sup> We test for equality of means by pairwise comparisons of means by group. For students whose families have income in the first quartile,  $t=-3.6$  for a test of equality of means with

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students with family income in the second quartile,  $t=-2.9$  for a test of equality of means with students with family income in the second quartile, and  $t=5.6$  for a test of equality of means with students with family income in the fourth quartile. For students with whose families have incomes in the second quartile,  $t=0.9$  for a test of equality of means with students with family income in the third quartile and  $t=9.0$  for a test of equality of means with students with family income in the fourth quartile. For students with family income in the third quartile, a  $t=8.6$  for a test of equality of means with students with family income in the fourth quartile.

<sup>104</sup> For the test of equality of mean PSL usage between private two-year for-profit institutions and two-year public institutions,  $t=12.6$  and for the test of equality of means between private two-year for-profit institutions and two-year private not-for-profit institutions  $t=5.2$ .

<sup>105</sup> For the test of equality of mean PSL usage between private four-year for-profit institutions and four-year public institutions,  $t=16.3$  and for the test of equality of means between private four-year for-profit institutions and four-year private not-for-profit institutions  $t=10.7$ .

<sup>106</sup>  $t=3.0$ .

<sup>107</sup> These percentages are computed by dividing the point-estimate of the proportion of students with both non-private and private loans by the sum of the proportion of students with private and non-private loans and the proportion of students with private loans only in the appropriate institution sector category.

<sup>108</sup>  $t=28.3$ .

<sup>109</sup> Obtained by dividing the sum of the proportion of students with PSL only and the proportion of students with PSL and non-private loans by the sum of the proportion of students with PSL only, the proportion of students with PSL and non-private loans, and the proportion of students with non-private loans only.

<sup>110</sup>  $t=26.8$ .

<sup>111</sup> This does not differ significantly from the proportion who use PSLs among students in bachelor's degree programs:  $t=1.7$ .

<sup>112</sup>  $t=15.8$ .

<sup>113</sup>  $t=3.5$ .

<sup>114</sup>  $t=5.3$ .

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<sup>115</sup> t=4.2.

<sup>116</sup> t=5.9.

<sup>117</sup> t=5.9.

<sup>118</sup> t=6.1.

<sup>119</sup> Tabulations from NPSAS:08 using the following variables: PRIVPACK, TOTGRT, PAREDUC, INATHAMT, TOTWKST and OTHTYPE.

<sup>120</sup> The proportion of students with non-private loans only who have grants is 5.3 percentage points higher than the proportion of students with a combination of non-private and private loans (t=5.1).

<sup>121</sup> The difference in mean grant amounts for students with non-private loans only and students with a both non-private loans and private loans is \$48, which is not statistically significant (t=0.3).

<sup>122</sup> There is a 1.1 percentage point difference in work study participation between the proportion of students who have a combination of non-private and private loans and students with non-private loans only, but this difference is not statistically significant at the 95% confidence level (t=1.68).

<sup>123</sup> This is obtained by dividing the percentage of students who filed a FAFSA but did not receive a Stafford loan (10.9%) by the total percentage of students who filed a FAFSA (100% - 12.2%).  $12.4\% = 10.9\%/88.8\%$ .

<sup>124</sup> Obtained by dividing the percentage of PSL borrowers who obtained a Stafford loan and received less than the maximum amount (31.4%) by the total percentage of PSL borrowers who received Stafford loans (the 31.4% of PSL borrowers that did not exhaust their Stafford loan limits and the 45.5% of PSL borrowers who exhausted their PSL).

<sup>125</sup> For individuals who started at public 4-year schools: t=2.8 for the test of equality of means with individuals who started at private for-profit 4 year institutions, t=3.0 for the test of equality of means with individuals who started at public 2-year institutions, t=3.2 for the test of equality of means with individuals who started at private not-for-profit 2 year schools, t=6.3 for the test of equality of means with individuals who started at private-for-profit two-year schools, and t=9.7 for the test of equality of means with individuals who started at private-for-profit less than two-year schools. For individuals who started at private not-for-profit 4-year schools: t=3.4 for the test of equality of means with individuals who started at private for-profit 4 year institutions, t=4.3 for the test of equality of means with individuals who started at public 2-year institutions, t=3.7 for the test of equality of

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means with individuals who started at private not-for-profit 2 year schools,  $t=7.5$  for the test of equality of means with individuals who started at private-for-profit two-year schools, and  $t=9.7$  for the test of equality of means with individuals who started at private-for-profit less than two-year schools.

<sup>126</sup>  $t=1.8$ .

<sup>127</sup> Computed from BPS:04/09 using variables PROUT6, RPYAMT09, and LNTY09B, restricted to PSL borrowers.

<sup>128</sup>  $t=3.0$ .

<sup>129</sup>  $t=4.1$ .

<sup>130</sup>  $t=3.2$ .

<sup>131</sup> For the test of equality of means for bachelor's degree recipients and certificate recipients,  $t=3.7$  and for the test of equality of means for bachelor's degree recipients and those who left without a degree  $t=5.4$ .

<sup>132</sup> For the test of equality of means for associate's degree recipients and certificate recipients,  $t=2.1$  and for the test of equality of means for associate's degree recipients and those who left without a degree  $t=2.5$ .

<sup>133</sup>  $t=0.5$ .

<sup>134</sup> See Figures 8, 9, 16, and 17.

<sup>135</sup> *Private (Non-Guaranteed) Student Loan Defaults: Stable at High Levels in 2012*, Moody's Student Loan Scholar, March 19, 2012, at p. 5.

<sup>136</sup> See Table 15.

<sup>137</sup> See First Marblehead presentation in Note 51.

<sup>138</sup> This discussion is limited to repayment mitigation plans where the borrower has economic hardship from underemployment and unemployment. All for-profit lenders offer some form of extended deferment for returning to school or for active duty military service.

<sup>139</sup> Income based repayment (IBR) ties a borrower's payment to their income and family size, Income contingent repayment (ICR) is similar to IBR except that it provides an option to cap payment at 20% of monthly discretionary income and allows for capitalization of

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interest of up to 10% of the original principal. Direct loans also offer public service loan forgiveness, which forgives the balance on the loan after 120 on-time monthly payments while employed full time by certain public service employers.

<sup>140</sup> For many, this was based on the TERI guarantor servicing rules. See Note 20.

<sup>141</sup> The prudential regulatory pressure on forbearance policies is enshrined in CBNE Policy Guidance 2010-02, issued by the OCC in August 2010. It specifically criticizes banks who offered FFELP-like forbearance programs. Consistent with this guidance, OCC-regulated banks now report offering forbearance only for one or two month duration, requiring extended continuous, timely payments before another forbearance will be considered.

<sup>142</sup> In their qualitative responses, Sample Lenders show uniform adoption of this policy, consistent with regulatory guidance interpreting FFIEC accounting rules. CBNE Policy Guidance 2010-02 issued by the OCC in August 2010.

<sup>143</sup> These trusts originally totaled \$10.8 billion . These trusts also include the so-called “modified graduated repayment system,” which allows up to a year of payments at \$50 and a further year of interest-only payments. Source: Sample Lender qualitative data.

<sup>144</sup> See the OCC interpretation of FFIECC accounting rules at Note 141.

<sup>145</sup> See Note 141. Sample Lender qualitative responses did not address treatment of co-signers with regard to the new practice of one month at a time forbearance.

<sup>146</sup> Principal write downs might be permitted by accounting rules for portfolio lenders. Securitization trustees likely would not have that discretion.

<sup>147</sup> That term is defined in section 1002(14) of Dodd-Frank and generally refers to laws with respect to which the CFPB has rulemaking authority.

<sup>148</sup> 15 USC § 1640 *et. seq.*

<sup>149</sup> 15 USC § 1691 *et. seq.*

<sup>150</sup> 15 USC § 1681 *et. seq.*

<sup>151</sup> 15 USC § 1601 *et. seq.*

<sup>152</sup> 15 USC § 41 *et. seq.*

<sup>153</sup> Title X of Dodd-Frank.

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<sup>154</sup> 12 C.F.R. § 1026.17.

<sup>155</sup> 12 C.F.R. § 1026.46 & 1026.47.

<sup>156</sup> 12 C.F.R. § 1026.46 & 1026.47.

<sup>157</sup> 12 C.F.R. § 1026.48(e).

<sup>158</sup> On July, 21, 2011, upon transfer of authority to the CFPB.

<sup>159</sup> Some forms of servicing, i.e., of loans that are “obtained” when they are not in default are not technically subject to FDCPA. 15 USC § 1692a(6)(F)(iii). The CFPB’s consideration of student loan servicing complaints is not limited to behaviors specifically proscribed by FDCPA.

<sup>160</sup> The College Board, *Trends in Student Aid 2006, 2007, 2008, 2009, 2010 & 2011*.

<sup>161</sup> There were adjustments to Stafford limits for independent undergraduates in 2008. See Table in Note 14.

<sup>162</sup> Moody’s Investors Service, *Direct-To-Consumer Student Loans: Higher Risk*, August 11, 2009.

<sup>163</sup> See Figure 6.

<sup>164</sup> Stafford loans and PSLs are both non-dischargeable in bankruptcy in almost all cases. 11 U.S.C. § 523(a) (8). Discharge is possible in the case of “undue hardship to the debtor and his dependents.”

This standard is very difficult to meet. *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987)

<sup>165</sup> P. L. 98-353, (July 10, 1984).

<sup>166</sup> See Note 20.

<sup>167</sup> For example, SLC, a Citibank affiliate, Key Bank and Bank of America, all made PSLs prior to 2005, frequently without using a non-profit guarantor.

<sup>168</sup> 11 U.S.C. § 523(a)(8).

<sup>169</sup> *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987).

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<sup>170</sup> See Table 16.

<sup>171</sup> The table shows bankruptcy status at a point in time as a percentage of total loans outstanding at a point in time. In the Sample Lender Portfolio data, bankruptcy status of a particular borrower changes over time, just as total portfolio size changes over time. Chapter 7 proceedings generally take less than a year. Chapter 13 proceedings can take up to five years. Therefore, the total loans that have been in bankruptcy out of the Sample Lender Portfolio is more than the 1.3% in that status at the end of 2011, but less than an arithmetic sum of all of the percentages shown for all the years in the table (i.e., less than 5.6%).

<sup>172</sup> The following table shows the spike in bankruptcy that coincided with the effective date of the bankruptcy law changes of October 17, 2005.

**Bankrupt Loans as a % of 120+ days past due loans (\$ in MM's)**

	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06
120+ Days Past Due	301.3	241.9	225.5	308.1	346.8	542.1
Loans in Bankruptcy	98.9	241.2	173.9	127.6	139.3	154.9
Bankrupt as a % of 120+ dpd	32.8%	99.7%	77.1%	41.4%	40.2%	28.6%

Source: Sample Lender data

<sup>173</sup> From the Sample Lender data, between 2Q05 and 4Q06 the underlying index increased by 222 bps while the mean interest rate in our sample rose by 303 bps.

<sup>174</sup> Many of the Sample Lenders did in fact use the TERI guaranty during the period in question. See Note 20 re: TERI.

<sup>175</sup> Impact of the Bankruptcy Exception for Private Student Loans or Private Student Loan Availability, Finaid.org, August 14, 2007.

<sup>176</sup> See Figure 8

<sup>177</sup> For example, TERI has a 25-year history of filing rates and recoveries on non-dischargeable PSLs. TERI's data on post-filing recoveries is a proxy for additional losses that would flow from a reversion to pre-2005 law.

<sup>178</sup> Moody's, *Moody's Weekly Credit Outlook*, (April 2, 2012) p. 22-23

<sup>179</sup> Moody's, *Moody's Weekly Credit Outlook*, (April 2, 2012) p. 22-23



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<sup>180</sup> Moody's, *Moody's Weekly Credit Outlook*, (April 2, 2012) p. 22-23

<sup>181</sup> H. Rept. 95-595 at 133 (1977).

<sup>182</sup> H.R. Rep. No. 95-595 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6424.

<sup>183</sup> See above.

<sup>184</sup> *Guaranteed Student Loan Program Bankruptcies* (GAO-HRD-77-83, April 1977).

<sup>185</sup> "Discharge, Exceptions to Discharge, and Objections to Discharge," p. 120, National Bankruptcy Review Commission available at:  
<http://govinfo.library.unt.edu/nbrc/report/07consum.html>

<sup>186</sup> See above.

<sup>187</sup> Arguably, if Congress finds that the current policy of non-dischargeability of PSLs for pre-creditworthy students creates more harm than benefit for students, then certainly the policy of non-dischargeability for loans with creditworthy co-signers would create more harm than benefit for consumers.

<sup>188</sup> 11 U.S.C. §707(b).

<sup>189</sup> 11 USC § 707(b)(3)(A).

<sup>190</sup> 11 U.S.C. §1328(a).

<sup>191</sup> 11 U.S.C. §1328(b).

<sup>192</sup> 11 U.S.C. §1325(b).

<sup>193</sup> 11 U.S.C. §707(a)(4).

<sup>194</sup> Education Amendments of 1976, P.L. 94-482, § 127(a), 90 Stat. 2141 (effective September 30, 1977).

<sup>195</sup> Higher Education Act Amendments of 1998, P.L. 105-244 §971 (1998).

<sup>196</sup> See *Association of Accredited Cosmetology v. Alexander*, 979 F.2d 859, 860 (D.C.Cir.1992); see also "Abuses in Federal Student Aid Programs," Report by the Permanent Subcommittee on Government Affairs, S. Rep. 102-58 (1991).

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<sup>197</sup> The ECOA prohibits discrimination because of race, color, religion, national origin, sex, marital status, age (if the applicant is old enough to enter into a contract), receipt of income from any public assistance program, or the exercise in good faith of a right under the Consumer Credit Protection Act. See 15 U.S.C. § 1691(a)(1).

<sup>198</sup> See 12 C.F.R. pt. 1002, Supp. I, § 1002.6, ¶ 6(a)-2.

<sup>199</sup> In the Attorney General's 2011 Annual Report to Congress pursuant to the ECOA Amendments of 1976, the Department of Justice reported that the FDIC had referred a matter on student loan pricing discrimination. As of the date of the 2011 Annual Report, the Department of Justice was investigating this matter. See U.S. Dept. of Justice Annual Report to Congress Pursuant to the Equal Credit Opportunity Act, at 15 and 18 (2012).

<sup>200</sup> In 2007, a class-action lawsuit was filed against Sallie Mae, the largest private education lender in the country, alleging discrimination based on the use of CDR in setting eligibility cutoffs, as well as underwriting and pricing student loans. See Rodriguez et al v. Sallie Mae, Inc. and SLM Corporation, D.Conn., Case No. 3:07-cv-01866-WWE. The public docket in that case indicates that the matter settled.

<sup>201</sup> Most Sample Lenders also report reliance on other nominal criteria such as requiring that a school be Title IV eligible, be located in the United States or Canada, and have had no sanctions imposed by the Department related to financial, administrative, or loan performance reasons. Some Sample Lenders report an attempt to mitigate the effect of CDR cutoffs by excepting Historically Black Colleges and Universities.

<sup>202</sup> An analysis of other institution-specific criteria such as graduation rate is beyond the scope of this Report; however, we did analyze the correlation of CDR to graduation rate and found the two variables to be highly correlated to each other. Accordingly, setting eligibility cutoffs based on graduation rate may present similar concerns to setting cutoffs based on CDR.

<sup>203</sup> 12 U.S.C. § 2801, *et seq.*

<sup>204</sup> See Regulation B, 12 C.F.R. §§ 1002.5 and 1002.13.

<sup>205</sup> The ability to obtain such data may be spread across multiple federal regulators to the extent that some student lenders are not subject to direct exclusive examination by the Bureau, if they have less than ten billion dollars in assets.

<sup>206</sup> To analyze the relationship between CDR and schools' racial and ethnic demographics we studied 2007, 2008, and 2009 IPEDS data on school characteristics and enrollment, including statistics on race and ethnicity, with the Department's official CDRs from 2007,

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2008, and 2009. Due to the two-year nature of the statistic, 2007, 2008, and 2009 are the three most recent CDR datasets available as of the writing of this Report.

<sup>207</sup> The Agencies also carried out a regression analysis with CDR as the dependent variable and various racial and ethnic demographic categories as the explanatory variables. This analysis confirmed the results shown in Table 20. For example, the regression analysis showed that for 2009 a 1% increase in CDR corresponded to a 0.6% increase in the percentage of African-American students. For 2007 and 2008, a 1% increase in CDR produced a 0.7% increase in African-American enrollment. The comparable percentages for Hispanics ranged from 0.7% to 0.9% during the period.

<sup>208</sup> Results for the 2006-2007 and 2007-2008 academic years can be reviewed in the Data Appendix, see Appendix Figure 6. We tested the 8% cutoff because it is the most common CDR cutoff used by Sample Lenders, not because it has any obvious intrinsic predictive value.

<sup>209</sup> If a group has the same distribution as the overall population of students the odds ratio would be "1"; if a group has an odds ratio of "2" it would imply that students in the group are twice as likely as students in general to attend a school above the threshold; if a group has an odds ratio of "0.5" it would imply that students in the group are half as likely as students in general to attend a school above the threshold.

<sup>210</sup> Both the 8% and 12% calculations are statistically significant at the 95% confidence level.

<sup>211</sup> Results for the 2006-2007 and 2007-2008 academic years can be reviewed in the Data Appendix.

<sup>212</sup> Source: IPEDS 2007 - 2008 and PEPS. Data are reported for the 50 States, D.C., Puerto Rico, and the territories.

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